UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

UNITED STATES SECURITIES) Case No.
AND EXCHANGE COMMISSION,) 3:20-cv-00076(WMC)
)
Plaintiff,)
)
v.)
)
EDWARD S. WALCZAK,)
)
Defendant.)
_____________________________)

REMOTE VIDEOTAPED DEPOSITION OF EDWARD WALCZAK
Tuesday, July 27, 2021

Reported By:
Vanese Killingbeck, RPR
JOB No. 210727VK

APPEARANCES:
For Plaintiff:
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
BY: MICHAEL D. FOSTER
Attorney at Law
175 West Jackson Boulevard, Suite 1450
Chicago, Illinois 60604
(312) 353-7390 (312) 353-7398 FAX
fostermi@sec.gov

- and -

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
BY: JAKE SCHMIDT
Attorney at Law
175 West Jackson Boulevard, Suite 1450
Chicago, Illinois 60604
(312) 353-7390 (312) 353-7398 FAX
schmidtj@sec.gov

For Defendant Edward S. Walczak:

ZILIAK LAW, LLC
BY: ZACHARY ZILIAK
Attorney at Law
141 West Jackson Boulevard, Suite 4048
Chicago, Illinois 60604
(312) 462-3353 (312)277-7347 FAX
zachary@ziliak.com

- and -

ZILIAK LAW, LLC
BY: STEVE BYLINA
Attorney at Law
141 West Jackson Boulevard, Suite 4048
Chicago, Illinois 60604
(312) 462-3353 (312)277-7347 FAX
sbylina@ziliak.com

APPEARANCES (Continued):

For Defendant Edward S. Walczak:
KOPECKY SCHUMACHER ROSENBURG, LLC
BY: JAMES L. KOPECKY
Attorney at Law
120 North LaSalle Street, Suite 2000
Chicago, Illinois 60602
(312) 380-6552
jkopecky@ksrlaw.com

Videographer:

Rashad Hunter

INDEX

EXHIBITS

EXHIBITS CONT'D

EXHIBIT NO.	DESCRIPTION	PAGE
Exhibit 25	01/02/17 E-mail Exchange with Brandon Schwulst	228
Exhibit 28	02/14/17 E-mail Exchange with Mr. Szilagyi	240
Exhibit 29	12/10/16 E-mail Exchange with Ms. Rios	242
Exhibit 34	02/27/17 Transcript of Open House Call	261
Exhibit 36	Answer to SEC's Complaint	279

Remote Proceedings
10:38 a.m. to 7:18 p.m.
- - - - -

VIDEOGRAPHER: Good morning, everyone. Here begins the videotaped deposition of Edward Walczak, testifying in the matter of SEC versus Walczak. Today's date is July 27th, 2021. The time on the record is 9:38 a.m.

My name is Rashad Hunter, the videographer. Our court reporter today is Vanese Killingbeck.

Counsel, will you please introduce yourselves for the record and the witness will be sworn.

MR. FOSTER: Mike Foster on behalf of Securities and Exchange Commission.

MR. SCHMIDT: Hi. Jake Schmidt on behalf of the Securities and Exchange Commission.

MR. KOPECKY: We have Jim Kopecky, Steve Bylina, and Zachary Ziliak on behalf of Ed Walczak.

///
///
///

EDWARD WALCZAK,

having been first duly sworn, was examined and testified as follows:

EXAMINATION

BY MR. FOSTER:

Q. Good morning, Mr. Walczak. Again, we met sometime ago briefly, but I'm one of the attorneys for the SEC in this litigation. And before we get started, I'm just going to cover a few preliminaries. I'd ask that if all attendees who are not actively involved in the -- in the questioning or stating objections mute their microphones, unless -- until they speak. That will help with the audio quality. I'd also ask that the parties and counsel identify on the record if other individuals are present with them physically at any time during the deposition. I don't believe that's the case.

Mr. Walczak, you and Mr. Kopecky are in separate locations?

A. Correct.

Q. Is that correct?

A. Correct.

Q. Okay. You're by yourself -- you're by yourself, then, in an office?

A. I am.

Q. Okay. This deposition is being recorded by a videographer. So no other participants should record or otherwise capture the images on the screen during the deposition.

And the oath that was just administered was given remotely. Mr. Walczak, just to confirm that you consent to taking an oath to swear to tell the truth remotely via audio-visual means rather than in person?

A. I do.

Q. And you agree that it has the same -- same -- the oath has the same effect as if it was administered in person, correct?

A. I agree.

Q. Thank you. And you're represented today by Mr. Kopecky, among other counsel, correct?

A. That's correct.

Q. The notice of deposition for your testimony was served on Mr. Kopecky. I've already marked that amended notice of deposition as Exhibit 1. And I've moved that into the marked exhibit folder in Egnyte.

Given that we are conducting this testimony via Webex, I'd also want to ask you to

Page 9

confirm a few other things before we -- we get into the substance.

Do you agree that you will not review or rely on any documents, including notes or websites or e-mails outside of the exhibits during testimony, unless you so identify and make that part of the record?

A. I agree.

(Exhibit 1 was marked for identification.)

BY MR. FOSTER:

Q. Do you agree that you will not have any other applications open on your computer, other than the video conferencing application for the deposition for Egnyte, or presumably you have, you know, a viewer that you're using to -- to view the exhibits outside of Egnyte. So outside of those applications, you agree not to have any other applications open?

A. I agree. I should close some down now, if that's a constraint.

Q. Why don't you give -- give me the favor and do that just so we'll get as far as that goes.

A. All right. Everything is closed. I feared that I had also closed the meeting, but it looks like we're still here.

Page 10

Q. Okay. Thank you.

Two -- two last points on -- on sort of the Webex format that we're -- we're using. Will you agree not to engage in any communications, including not limited to e-mails, texts, chats, et cetera, pertaining to the subject matter of this testimony with anyone other than the SEC and counsel today?

A. I agree.

Q. And will you alert the SEC if and when you and your counsel are communicating privately while the testimony session is taking place?

A. Yes.

Q. Okay. Obviously, you know, if you and your counsel -- if you want to have a discussion with your counsel, that's a separate issue. We'll -- and we can go off the record at an -- an appropriate time and you can have -- you can have that discussion offline.

You provided testimony, obviously, during the SEC's presuit investigation, so I know you have some familiarity with the process, but a few last reminders sort of before we get started. Please answer verbally, since our dialogue is being transcribed into a written transcript as well as

Page 11

being recorded. And to further help the reporter out, let's try not to speak over one another. So allow me to finish a question before beginning your answer, and I'll do my best to reciprocate, and that will help the court reporter take down what's being said. If you don't understand a question, please let me know. I'll try to restate it or rephrase it. If you answer a question, I'll assume you heard it and understood it; is that fair?

A. It is.

MR. KOPECKY: Standard objection as it doesn't mean he understood it the way you intended it.

BY MR. FOSTER:

Q. If you need a break at anytime, Mr. Walczak, let me know, we'll take one. I would just ask that you bear with me if a question was pending, and we'll first finish that particular question and answer, and then we can -- we can take a break. And we'll take -- we'll take a few breaks, I'm sure, as we go forward.

If there's anything you want to clarify, or if you remember something, please let me know, and we'll revisit that issue at the appropriate time. And is there anything that will grant you

Page 12

from giving full and complete answers here today?

A. Not that I'm aware of, no.

Q. Is there anything that might impair your ability to understand the questions that I -- that I ask? For example, are you sick, taking medication, any other reason that you can think of that would cause you not to be able to answer my questions fully?

A. No.

Q. All right. As I mentioned, I think everybody's aware, that you provided testimony over -- over several days during the -- the presuit investigation in this matter. You're also a defendant in a lawsuit filed by the CFTC. Are you otherwise involved in any legal proceedings since this case was filed in -- in January 2020?

A. Have I been, or am I currently? Which is your question?

Q. Sure. How about have you been?

A. I have been.

Q. Okay. And were any of those matters that you were -- you've been involved in, are those -- any of those still pending?

A. Not at this time, no.

Q. Okay. And what -- was there one matter?

Page 13

More than one matter?
A. There was one matter, an arbitration between myself and my previous contract employer.
Q. Okay. And I assume you're referring to Catalyst Capital Advisors?
A. Correct.
Q. Okay. And so you were -- you were a party to an arbitration with Catalyst, and that arbitration has -- has wrapped up?
A. It has.
Q. Okay. As -- as we go forward today, if I refer to Catalyst, you'll understand that I'm referring to Catalyst Capital Advisors?
A. Yes. Mr. Foster, if I make -- if I can make one quick note on video. Your audio and video is -- appears to me on my end to be a little out of sync. It's not a problem now. But I just want to alert you that if it becomes a problem, I'll mention it.
Q. Okay. Sure. No problem. If the problem persists --
MR. KOPECKY: You look like a bad movie. You look like a poorly dubbed movie.
MR. FOSTER: Okay. I can -- why don't we -- why don't we pause for one second, and I'll

Page 14

just re -- try to reconnect my audio.
Okay. How is that? Is that any better?
THE WITNESS: Again, I'm not having any trouble hearing the audio. It's just a little distracting with the disconnect. I didn't know if there was any -- with the disconnect, it seems better.
MR. FOSTER: Okay. All right. Well, when we -- when we take a break, I'll try to -- I'll try to -- I can reconnect the -- the video as well and see if that fixes the problem.
BY MR. FOSTER:
Q. All right. So you previously were affiliated with -- with Catalyst, that's right?
A. I was employed under a contract with them, yes.
Q. Okay. And that began in approximately August of 2013?
A. Yes, approximately then.
Q. Okay. And that was when the Hedged Futures Strategy Fund was launched as a Catalyst advised mutual fund?
A. Correct.
Q. Okay. So today when I refer to the head futures -- the Hedged Futures Strategy Fund, I'll

Page 15

simply refer to it as Hedged Futures or the Fund, and you'll understand what I mean?
A. Yes.
Q. Okay. And you were previously the portfolio manager for that fund?
A. Yes.
Q. Okay. And so starting in approximately August 2013 until -- until when did that no longer hold true?
A. I was terminated on January 27th of 2020.
Q. And were you given a reason for your termination?
A. No.
Q. Who -- who informed you that you were terminated?
A. I received an e-mail from Jerry Szilagyi.
Q. And what did that e-mail say?
A. The e-mail, without recalling exact language, said that I was terminated effective immediately for cause.
Q. And did Mr. Szilagyi identify the reasons that you were terminated for cause?
A. He did not.
Q. Did you subsequently ask him?
A. I did.

Page 16

Q. Okay. Soon after receiving that e-mail?
A. Yes.
Q. How did you -- was that via e-mail or phone communication?
A. Via e-mail.
Q. And did he respond to you?
A. No.
Q. So at any point did you ask whether -- over via e-mail, text, chat, or phone communication, did you have any discussion with Mr. Szilagyi as to why he informed you that you were terminated for cause?
A. No.
Q. Did you have that discussion with anyone else at Catalyst?
A. No.
Q. Did you come to learn at any point what -- what Catalyst's basis for terminating you for cause was?
A. They did not specify to me any cause as defined by my employment agreement, no.
Q. Whether -- whether -- in your view defined by your employment agreement or otherwise, did you -- did you come to learn in any way, shape, or form, what Catalyst's position was, why they

informed you that you were terminated for cause?
A. I don't recall exactly. We had no communication until the arbitration proceedings, so a great deal of testimony during an arbitration or -- proceedings. I don't honestly recall a specific agent of cause. Lots of -- lots of, as I said, testimony. But, again, I can't -- can't recall a specific cause, again, as defined in the employment agreement.
Q. What was it -- was there a written statement or claim submitted by Catalyst in the arbitration proceeding?
A. I think they -- they had -- best of my recollection is they had several counter claims -- to initiate the arbitration, they had several counter claims.
Q. Okay. And there -- there was a document reflecting what their counter claims were?
A. Yes.
Q. Okay. And did you review that document?
A. I did.
Q. Okay. And did that -- that document provide an explanation from Catalyst's viewpoint as to why they terminated you for cause?
A. My recollection of their counter claims

didn't involve cause, rather, they were seeking monetary damages from me for various matters.
Q. Okay. And are you able to say why -- why they were seeking monetary damages from you?
A. Well, I can recall the -- the -- one of the claims was that they wanted me to share in their settlement with your agency and with the CFTC. One of their claims was that they wanted me to share in their settlement of a private, civil lawsuit against them. And I think the third claim was related to -- to their belief that I had damaged their business subsequent to the regulatory investigation.
Q. And you mentioned that the arbitration is no longer pending. So was there -- was there a decision by the arbitrator or arbitration panel that -- that concluded the proceeding?
A. Yeah. And I -- and I guess to -- to be completely correct, there is still -- there's still an awards phase of the arbitration is pending. The claims have been adjudicated -- again, I apologize for my lack of precision in some of the legal terms, but the arbitrator awarded in my favor on my claims and filed against Catalyst on their claims.
And as I said, we're -- there's still a final determination of the award amount, but they --

the decision on the claims themselves has been concluded.
Q. Okay. And so you -- you mentioned that the arbitrator ruled in your favor on your claims.
I'm sorry, I missed what -- what was the ruling with respect to Catalyst's counterclaims?
A. He -- he denied their counterclaims.
Q. And when was the -- if you can remind me, when was the arbitration hearing?
A. Roughly a month ago, I think.
Q. And did you testify in that proceeding?
A. I did.
Q. Okay. And let me be a little more specific. So in advance of the actual hearing itself, did you provide any sworn testimony in a -- in a setting similar to today's deposition?
A. I did.
Q. And then I take it -- I understand you to say that you also testified at the hearing itself?
A. Yes.
Q. Okay. And did you do that in person?
A. Yes. Well, to be -- to be clear, I gave a video deposition in advance of the hearing. The hearing was conducted in person.
Q. And where was the hearing held?

A. In Chicago.
Q. And did you testify just in -- on one given day or over multiple days?
A. I believe I testified on two different days.
Q. All right. So just circling back for a moment. The -- the e-mail from Mr. Szilagyi informing you that you were being terminated for cause, that was in January of 2020?
A. I believe it was January 27th, yes.
Q. So just prior to that message from Mr. Szilagyi, you were -- you were still the portfolio manager for the Hedged Futures Fund?
A. Yes.
Q. And were you the portfolio manager for any other Catalyst-advised fund at that time?
A. Not at that time, no.
Q. What about outside of Catalyst? Were you -- were you managing any other funds or portfolios besides the Hedged Futures Fund?
A. Only private accounts, no -- no publicly available funds.
Q. Okay. How many private accounts were you managing at the time that Catalyst terminated your contract?

Page 21

A. I don't recall if there were multiple accounts at that time there are today. Again, multiple accounts, meaning proprietary exempt accounts.
Q. Sure. Why don't you just tell me, as best you can, what you're referring to when you -- when you told me you were managing private accounts? Who -- who were the -- who were the account -- the account holders, and were you doing this through some other vehicle or corporation?
A. Yeah. A number of entity accounts, essentially controlled by -- controlled by myself and my wife.
Q. So was there a corporate entity or form through which you were --
A. Yes. Several. I managed a -- again, an exempt pool, which consisted mostly of family members and myself and my wife. I managed -- again, at that time I don't know if I had -- I don't recall specifically back in January '20. In fact, I don't think I had other accounts open today. I do have accounts open under other entities.
Q. And --
A. You know, I -- yeah. And, again, my memory's just not completely clear about that

Page 22

specific date. I could certainly tell you what I have going now.
Q. Sure. One -- we'll get to that in one second.
So the account that you believe that you recall, your best recollection there was -- there was one account you were managing at that time. What was the name of the -- the entity?
A. It was called the -- it's called Arlington Holdings.
Q. And you -- were you the sole sort of decisionmaker for the -- the investments for that -- the Arlington Holdings account?
A. Well, I was certainly the trader. There's a -- it's managed by an entity, again, controlled by myself and my wife. There are others who contribute opinion and business advice, minority shareholders, a cousin, et cetera.
Q. Okay. Is the managing entity controlled by you and your wife, Arlington Holdings, or is that a different --
A. That's the -- that's the Fund. The -- the managing partner for that fund is Arlington Capital Management.
Q. So since you were terminated or informed

Page 23

by Mr. Szilagyi that your contract was terminated in late January 2020, what have you been doing for employ -- employment, if anything?
A. I have not been formally employed.
Q. Are you earning income through some activity?
A. I trade.
Q. Trade for yourself, or you're -- it sounds like you're managing accounts for -- for yourself and other people?
A. Again, I have -- still manage the exempt fund, but I don't take any income from it. My income is derived from personal accounts, my wife's account, an entity controlled by myself and my wife.
Q. So how many different accounts are you trading through currently?
A. Currently, three.
Q. Okay. And just -- we're not belaboring, but just run those down for me. So one would be the Arlington Holdings, and the other two are?
A. A trust account in my wife's name, and another entity by the name of Preservation Holdings.
Q. And, I'm sorry, I didn't catch that last name, Preservation Holdings?
A. Preservation Holdings.

Page 24

Q. And did you have an interest in -- in the funds held by Preservation Holdings?
A. Yes. It's a -- I don't remember the exact split, but it's myself and my wife.
Q. Besides your wife -- so it's Preservation Holdings, it's just you and your wife. The other account you mentioned was a trust for -- a trust for the benefit of your wife or the name of your wife?
A. Correct.
Q. And did she -- who's the beneficiary of that trust?
A. Honestly, I don't -- don't recall if she's the beneficiary or I'm the beneficiary. I don't recall how the trust was set up.
Q. Fair enough. But it's either you or her or both?
A. Correct.
Q. Okay. Then with respect to Arlington Holdings, are there any other sort of interested investors in the Fund, other than you and/or your wife?
A. There are.
Q. Okay. Other family members?
A. Some family members, some -- and, again,

the legal definition of family member, for example, I have a cousin in there. But, again, it's -- it's commodity pool that is exempt from regulation under an exemption whose name and number I can't quote.

Q. Okay. And across these three accounts, can you ballpark how much the -- an asset that you're managing?

A. $3 million currently.

Q. And how much of that capital is you or -- and/or your wife's?

A. Probably about myself and my wife specifically, maybe 2 million or 3.

Q. Okay. Let's turn back to the time when you were the portfolio manager for the Hedged Futures Fund. And, specifically, for the moment anyway, I may alter the time period, but I'm talking about basically the period from the Fund's formation as a mutual fund in or about August of 2013 through February 2017.

During that period, the -- the Fund held a portfolio of money market funds, short-term notes and bonds, and other low-risk fixed income instruments; is that fair?

A. Sure. Sure. During the life of the Fund, the -- I can say, with some certainty, we always held those types of instruments to some degree.

Q. And then in addition, the Fund held a large portfolio of options based on S&P 500 Index future contracts; is that right?

A. That's the other instrument that we traded in, yes.

Q. And the futures -- the futures option portfolio was responsible for virtually all of the Fund's risk; is that -- is that accurate?

A. I would say, yes, the risk and the appreciation potential. That's the instrument we used.

Q. And I know you testified regarding that the strategies that you employed in trading the options futures to earn a return for the Fund, but there were -- there were two strategies; is that right?

A. Well, there were many different elements to the strategy. I often tried to carve them up and explain the strategy into a -- a call side strategy and put side strategy.

Q. Okay. And so on the call side strategy, that was an above-the-market in call strategy; is that right?

A. Correct.

Q. And on the put side, it was a below-the-market put strategy?

A. Yes.

Q. Okay. Was there another, you know, sort of strategy that you would, you know, refer to other than those two in describing the overall strategy of the Fund?

A. Those -- and, again, to try to simplify a more complex option strategy, I did try to carve it up into those two strategies. There were -- there were times when we traded some options after money, so it was a -- it's a, you know -- a minor distinction to say, Well, sometimes we have after-money calls, sometimes we have in-the-money calls. But there was -- it was generally employed a call side strategy and a put side strategy, as you described. Not always, but most of the time, the calls were above-the-market, puts were below the market, sometimes out of the money, sometimes even a little bit in the money.

Q. With respect to the above-the-market call strategy, would you, then, purchase out-of-the-money call options as part of that strategy?

A. We very rarely, if -- on entry, as opposed to risk management or adjustment, we didn't often simply go out and purchase call options. That was, in fact, not a part of the strategy.

Q. Right. I'm sorry. So I should say you purchased out-of-the-money call options and sold options with strike prices even further above the market price of the purchased call options?

A. Correct. And that -- that was done as a single transaction, commonly known as a spread.

Q. And so the strike prices of both were -- were above the current market price of the underlying asset, correct?

A. The majority of the time, that's true, yes.

Q. At least upon initiation, right?

A. Yes.

Q. And if the market moved up into that range between the -- the long position and the options you had purchased and the short positions, meaning the options that were sold, the Fund would make money; is that correct?

A. Depending on the time frame, that's an area where we would like the market to be at expiration, in fact, even beyond the short strength. Again, it depends on the time frame in terms of how long the options had to expiration.

Page 29

Q. All right. But is that -- did that range between the -- the strike prices of the -- of the purchased options versus the options that were written or sold that -- that generates the profit? There was -- there was a target range between the two that would result in the Fund making money?

A. Well, the Fund could make money in a lot of different ways. And at expiration, expiring in that range was one of those ways, yes.

Q. All right. Why don't -- why don't you just tell me how -- how the Fund would make a profit from the above -- the market call strategy?

A. So the way you describe is one way, but, again, you could be in that range. And if you were in that range with a long enough time to expiration, you probably be -- not making money. You'd be losing money. As time passes, you start to make money in that range, and certainly an expiration, you would make money in that range. And, in fact, as I said, that expiration, you make money on the short option strength.

The other way you can make money is simply because the further out the money, short options tend to detain in value faster than the long options. So even if the market never approached

Page 30

that ideal profit range, the spread would gradually become profitable and could be exited at profit.

Sometimes changes in volatility, independent of price, would have a different impact and a lot of different ways on the long and short options, and that would also result in profit. Those -- you know, top of my head for the sake of answering your questions as succinctly as possible, those are three ways you could do it.

Q. And how would -- or how did the Fund lose money from the above-the-market call strategy?

A. Well, again, a couple different ways. One is the most common way is if the market advanced too rapidly, relative to the decay in the -- the short options position. That was the most -- the most common risk that -- that is inherent in those types of structures.

Q. So if the market reaches a certain point above the range of the -- between the -- the long options and the short options, the Fund could lose money?

A. Sure. But, again, it's important to know that you could -- you could certainly make money well beyond the short option that the -- the maximum profit occurs right at the short option strike, but

Page 31

it's symmetrical. There's equal profit ten points below as there is ten points above an expiration. So the -- the issue is in managing positions is really the element of time. In expiration, that's where you would like to be prior to expiration. You would rather not be up that high relative to the position in strength.

Q. And there's -- there's a -- there's a point, though, above the strikes where -- where both the long and short options are with the money that an expiration would cause the Fund to lose money on those -- on those trades, correct?

A. Correct.

Q. Okay. And was that true in part because you sold more options than you purchased?

A. At initiation, it was -- it was typical to -- you know, these were called -- again, not to become too technical, unless you would like me to, but these are called ratio spreads. Sometimes we did one long for two shorts. Sometimes one long for three shorts. Generally speaking, at initiation, you would sell more than the purchase. As we identified, the need to further hedge those positions, we'd then go back in and buy additional on call options or exit some of the shorts.

Page 32

But in initiations, it's fair to say that we sold more than we bought.

Q. So talking specifically about the above-the-market call strategy, what were the risks of -- of that strategy to the Fund?

A. The two primary risks were a rapid price appreciation to the upside. Again, rapid could mean a lot of different things. It depends on our kind of the environment, it depends on the structure, and, importantly, the time of expiration of the position. So rapid means outpacing the -- the time decay of the short option.

And, secondarily, in the very, very unusual circumstance that volatility built into the options, either increased overall or increased due to a shift in the pricing of the short options. So sometimes further out the money options increased the volatility and yours -- the money ones don't increase as rapidly, that's called a skew.

If the skew shifts, that's something that I -- I paid attention to when I was at risk. So primarily rapid price appreciation, and to a lesser degree, because it was very rare, an increase in volatility. Volatility in the options.

Q. And how did you assess or attempt to

measure those risks that you just described for the above-the-call market strategy for the Hedged Futures Fund?

A. Well, for -- for the entire fund, we used a menu of risk tools. A set of metrics, really operating metrics, but important part of operating the Fund was managing risks. So they were designed to identify the profile of the portfolio that -- that sort of out of balance on the risk side.

Q. Well, did you -- was there anything else you did to assess the risks of the portfolio future options --

A. Sure.

Q. Held by the Fund besides --

A. We modeled the -- we modeled the portfolio and, you know, similar to an equity portfolio where you can use various models to understand whether an equity is fairly priced and it's a set of an appreciation target or so forth. We used options models to try to and -- under various scenarios, understand how the portfolio might perform.

Q. Okay. And when you say -- when you're referring to modeling, in other words, did you use a computer program to assess the risk of the portfolio future options?

A. Yes.

Q. Okay. And was that computer program called OptionVue?

A. Yes.

Q. Was there any other computer program that you used for that purpose?

A. That's the --

Q. OptionVue --

A. That's the only option pricing modeling software that I used.

Q. Okay. And you used OptionVue on -- throughout the August 2013 through February 2017 time period?

A. Yes.

Q. Okay. Could you describe OptionVue for me?

A. I -- I don't know as a basis on your familiarity with options modeling software, but it -- it has -- again, in my somewhat limited experience with watching other options modeling software, I would say that OptionVue has all the basic elements of the ability to model pricing behavior based on several different options pricing models, including the most famous Black-Scholes, but others, as well as being able to model changes in,

again, a skew that I talked about where different options, series, expiration series, strike prices can change independent of a -- a general sense of what's happening in two options pricing in the marketplace.

So, again, it's the tool I used. I'm reasonably sure that it has many of the same tools as other modeling software.

I guess a good analogy would be, you know, if you say -- I mean, there's a car. Different cars have different features. Most cars have an accelerator, a brake pedal, a speedometer, et cetera. So it was a options modeling software, lots of different features.

Q. Okay. To be able to use the OptionVue tool, however, you first had to input information into OptionVue on the -- on the trade that you made?

A. Correct. I would have -- you would need to input whatever it is you want to model, correct.

Q. And then based on the trades you inputted, the program would then determine the portfolio's holdings at a given point in time?

A. Well, I'm not sure what you mean by determine the holdings. But if you input a portfolio, you could then use the software to do all

sorts what-if scenarios, modeling, calculations on various attributes to the portfolio.

Q. Well, meaning with respect to determining the portfolio's holding, if you enter a bunch of disparate trades with the -- with the program based on the aggregate that information on a -- on a -- and informing of the value of -- of those holdings?

A. Sure. Now, again, it would -- this is a modeling software, so it's telling you a value based on whatever assumptions you would like it to model. So -- and what time frame and what expiration series and so forth. So -- so it's not a -- it's not a artificial intelligence or ammo of any kind. It tells you what you ask it.

Q. Right. So based -- based on the trades that were -- were entered into the program, OptionVue could estimate future values of the portfolio at different time horizons?

A. Yeah. Again, not solely dependent on trades or positions, but on assumptions that the operator -- again, it's tools. It's a golf club, not a golfer. So it's -- it's the trader telling the program, Here's what I'm holding. Here's my expectation about volatility. Here's what time frame I'd like to look at. And then it would give

Page 37

you an estimate of what might happen to options prices over that period of time.

Again, similar to equities where you're going to create a discounted cash flow model, if that's what you're using, that's a common one, about what might happen, stock prices in the future. Maybe -- maybe its a good model, maybe it's not.

Q. Okay. Right. So then, I guess, make sure I understand you. So the OptionVue could estimate future values of the portfolio at different time horizons based on assumptions about price of the options, underline asset, in this case, the S&P 500 futures index contracts and -- as well as option volatilities?

A. Yes.

Q. So it's based on those assumptions --

A. That's -- that's correct. But, again, it's -- it's a model, and often pricing is ultimately determined by agreement between a buyer and seller, an exchange. And, again, similar -- similar equities, models to models, and prices determined in an auction environment. So -- so that -- and that's the caveat that I always understood in using models as a tool.

Q. Did you use OptionVue to help you select

Page 38

which options to buy and sell?

A. I did.

Q. Did you use OptionVue to forecast possible future values of the options portfolio held by the Fund?

A. Again, I used it to model what might happen, if a given set of assumptions came to pass.

Q. And you did that in OptionVue to assess the risk of the options portfolio held by the Fund?

A. That was one -- one thing I used OptionVue for, yes. It was not primarily a -- the primary risk management tool, but it was an important tool that I used to assess risks.

Q. All right. So let me just break that down a little bit.

OptionVue -- OptionVue was an important tool that you used to assess risk to the Fund, but it was not -- not the primary tool?

A. Yeah. I wouldn't say it was the primary, because we used -- as I had mentioned, we used a whole suite of indicators and metrics. OptionVue is certainly an important model of how the portfolio might perform, but not the only thing that I used.

Q. Okay. What's the other suite of metrics that you're talking about?

Page 39

A. Well, again, I -- early on prior to the formation of mutual fund, I traded the strategy where -- in a commodity pool. And at that time I developed a series of really of operating parameters, which later became ways to control risk. You know, it's -- it's hard to sometimes decouple risk from opportunity, because they go hand in hand, and it's balanced. So these are operating parameters designed to allow a -- a reasonable greater return, as well as trying to control volatility and risking the Fund. So these suites -- or this suite of metrics included things like looking at how many positions we had on a normalized and size would be column and scope. So in other words, positions per million dollars is how we normalized it. Obviously, twice as many positions come. Twice the size is essentially the same level of position of funds, so we normalized it.

We identified, as you may be familiar, when you trade a derivative security like this, we traded at the CME. Our clearing brokers required a collateral department, or collateral deposit to secure the potential risk in the portfolio. And, again, that's called margin.

Margin has a different connotation

Page 40

sometimes in the securities business. But the margins are collateral deposit to the secured risk, protect the broker from risk so we wouldn't be -- we had -- we monitored and had limitations on the amount of the funds capital we were willing to devote to this collateral requirement.

And -- and, again, the -- the broker standard requirements are a very good risk tool, because it's a very sophisticated algorithm. They run a Monte Carlo simulation. And so we -- I'm not always a very good risk measure for that reason. This was more sophisticated than -- than a simple options pricing model. It measured different scenarios around price and volatility and -- and determined a bond amount necessary to secure the portfolio.

So we used the position sizing. We used margin. We used open option premium. One of the things that I -- I learned in turn -- in the type of options spread and option training I do is that volatility's very important. Many of the Greeks contributed in many different ways, and this is the market groups. All the Greek values change. So I tried not to rely on any one specific Greek, and instead we monitored our -- the total value of our

open option premium. That was basically the sum total of the interaction of all the Greeks on the portfolio, and what's at risk was -- was inherent in the position. So those are the three legs on the stool: Positions, margin, open option premium.

Later on in running the mutual fund, the advisor and I agreed to -- begin to monitor just simple changes. We did not ask the value of the Fund, and to react to certain levels of changes drawn on from there.

Q. Any of the risk metrics that you just described that -- or sort of you were saying are separate outside of OptionVue, did you use any of those risk metrics to stress test the portfolio?

A. No. The -- the -- those are metrics that intended to be, you know, end-of-day values. You know, we didn't use a value at-risk calculation, but -- but a similar scenario where you could take a snapshot of the portfolio and identify whether this -- whether the portfolio was in a potentially risky situation based on those values. The stress testing I did with -- with the OptionVue software.

Q. Stress testing you did exclusively through OptionVue, correct?

A. Yeah. I mean, again, when you talk about

stress testing and modeling, that was my modeling tool, so that's what I did.

Q. Did the risk -- the risk metrics that you just gave an overview of, did any of those provide information about either potential future losses or about how the portfolio would perform under certain market conditions?

A. Yeah. I think all of them, one way or the other were designed to do that. In other words, each of them were a measure of the current elevated -- elevated -- the current level of risk in the portfolio. So if you -- if you're looking at these metrics and they're at the low end of the scale, then -- then you can have some confidence that the moving forward risk in the portfolio is lower than if they're right at the top of their scale, which the scales were driven by my experience and the advisor's experience and the Fund's performance and its performance relative to the levels he's indicated.

So they -- they weren't modeling tools, but they did certainly indicate whether there was -- to what extent there was an elevated risk in the portfolio on any given day. And if there's an elevated risk, then moving forward, you're -- you're

likely to have a higher possibility of loss than if they're a reduced risk. That's how their design image is.

Q. But the risk metrics would inform you if there was elevated risk present in the portfolio, but they -- did they tell you whether -- based on if the market changed in certain ways, whether -- what -- what -- how that risk might change in one direction or the other?

A. They -- they didn't, but if the market changed, then I would expect to observe that the levels indicated by those metrics will also change.

Q. So those metrics, those risk metrics you're talking about described or purported to capture what the existing risk level in the Fund was as opposed to what the -- what risk might be presented based on changes in market conditions; is that right?

A. Correct.

Q. I want to talk about -- let's go back to -- and I appreciate you walking me through that. With respect to stressing the portfolio in OptionVue, let's circle back to that topic now.

And when you say stressing the portfolio, we're referring to, you know, considering --

consideration of hypothetical scenarios, such as an increase in the S&P 500 that might cause losses or gains and examining the magnitude of those losses or gains from that market movement; is that right?

A. That's fair.

Q. Okay. So you used OptionVue to stress the futures options portfolio. What exactly were you stressing for? Can you walk me through what you were -- what your -- the nature of your stress testing?

A. Sure. So -- so typically an important thing to note is the stress test -- the actual attributes to the stress testing that I did were based both on whatever the market conditions were at the time. That's the extreme example from -- from what recent history is. You would do a different price extension.

In other words, if I wanted to look -- well, a couple characteristics. So the stress tests are dependent on what are the market conditions and what's the portfolio. So if I've got a large concentration of options in expirations three months from today, then I'm looking at what might happen over the course of three months, and do I need to do something about this under various scenarios. Then

Page 45

I consider what -- what's the current market condition. Are we in October of 2008? Are we in March of 2020? Or are we in January or February 2017. Very, very different market conditions.

So in March of 2020, since it's fresher in -- in our memories, it would be very reasonable to say, I better find out what's going to happen to -- if the market is limit down to 7 percent at the open tomorrow. In February of 2017, a 7-percent move. That's a reasonable year out based on voluntary -- volatility conditions.

So, first, I would try to assess the volatility in the marketplace largely based on pure math about how volatile the market has been and the calculation. In fact, it gets done by -- by index as you can look up or you can do it yourself as well easily. So what's the volatility conditions in the market? How's it behaving? Is it flat? Is it trending higher? Trending lower? What's it doing? And I would then try to make a determination about -- then I would look at the portfolio and say, Where is my risk? What expiration period? How spread out am I? Where do I need to look? How far do I need to extend price? Or do I need to do a

Page 46

volatility section?

So a lot of environmental considerations and some -- some judgment on my part as well about how to stress the portfolio with some areas to apply to it. I would plug those scenarios into the -- into the OptionVue model. It would give me results. Again, the results would be on multiple time frames. I would use my experience and judgment to evaluate those results, A, from a pure litmus test. Is that making sense? Is the model behaving correctly? Is there -- is there a hiccup in it somewhere? Is this reasonable based on real world experience? And based on the sort of digestion of all these factors, I would decide whether or not there was a need to make some sort of risk adjustment.

I did the same thing in terms of entries and in terms of considering trades. Only the trade scenario was less about risk and more about if I put this on, what are the circumstances under which it's gonna make money? Is it a reasonable trade? What does it do to the portfolio profile? So -- so everything I've described to you in a little bit of a lengthy manor is a decision process of how I use a tool to help me make a judgment out of what to do.

Q. So the scenario that you were -- you said

Page 47

you were plugging into OptionVue or considering in OptionVue, those scenarios were -- were some combination of price -- price -- potential price movement, volatility, and a particular time horizon; is that -- is that right?

A. Correct.

Q. And so were there -- were there scenarios that -- you know, involving those three factors that you typically considered in stressing the portfolio?

A. I mean, there's some generic scenarios. I think, you know, when I would explain to people what I was doing, sometimes it's hypothetical, so I throw out numbers. But they really -- as I said, it didn't make a lot of sense to stress a portfolio three months out, if I didn't have options three months out. It didn't -- it didn't make sense to stress a portfolio in a very low vol environment for a 10-percent move. It didn't make sense to stress a high volatility environment for only a 10-percent move.

So if -- if there were -- you know, in a -- in the average market, you know, I would fire up OptionVue. It actually gives you five different time frames. I can adjust those or take them. But it was really fairly market dependent.

Page 48

Q. You mentioned that there were -- when you were describing in that -- in that response, you mentioned when you're describing how to stress the portfolio that, you know, there were occasions when you threw out numbers. Can I focus on that for a second? When -- when you're -- when -- who did you mean when you're describing that portfolio to whom?

A. So during -- during my time managing the Fund, the advisor asked me to, from time to time, answer questions about how this whole thing worked. It's a fairly complicated subject for many, so we held -- I think you're probably aware. We held some -- some calls in which I took questions and answers about how was the Fund positioned at that particular time? What was I looking at? What was I doing? Lots of calls, no real set script or agenda, then give a general overview of what was going on in the Fund.

And I would take questions, and from time to time, people would ask about -- you know, about risk and about what I did to look at risk. It wasn't really common, but it -- you know, in terms of the number of calls and how often those questions came up, but they did come up.

Oftentimes they were more generic

questions about how do you manage a portfolio like this, and I would explain or what's the strategy. Much more common really to describe the strategy as you started your inquiries with regard to the call strategy, put strategy. As I mentioned, that's a -- you know, that's a good way to carve it up to help people have a more generic kind of understanding of what's going on.

Q. Okay. So these -- these -- half these calls here that you mentioned, are these -- what -- you know, have they been referred to as open house calls? Are you familiar with that -- that name for those -- those calls?

A. Yeah.

Q. And these were -- these were telephonic calls in which you -- you gave an overview of the strategy at a given time, and answered the questions from interested financial advisors; is that right?

A. Yeah. I mean, you know, I have a -- to this day, honestly, I have a limited -- limited understanding of -- really of the persistence of the advisors to say, Hey, look just give them a call. We're going to bring some financial advisors in and ask them questions about options. It's not a subject everyone's comfortable with. So -- so I

did. So I -- you know, like I said, I have a limited understanding of the audience other than I was told they were financial advisor. I think that's true. And I got on the phone when I was asked to.

Q. Okay. And in that response, sir, you said that you were asked by advisors to -- to give these presentations to financial advisors. Did you mean wholesalers? Did you?

A. No, I'm sorry. I'm using the advisor in my terminology for Catalyst. I'll start over again.

Catalyst asked me to get on calls with -- as I said, I -- I never saw an invitation list. I have no reason to think otherwise. But I was told this was a collection of financial advisors. I don't know how they were invited or who was invited or what. I was told that that's the audience, so that I could be, you know, a little more comfortable with being transparent about what I did, and, for example, if it were direct retail investors.

Q. But you understood the financial advisors that participated in those calls were, in turn, making investments on behalf of investors; is that right?

A. Honestly, I don't know very much about the

financial advisor community. I don't know whose got discretionary authority or what. It certainly seemed reasonable. All I knew is that -- the important fact to me was these guys were -- were purported to be sophisticated people who understood -- honestly, you know, they understood to read documents and disclosure statements and to ask questions if they weren't certain. And that's how I -- again, that's how I managed the transparence of my -- my remarks. But, honestly, I don't know what they did with client money or what -- what might be going on behind the scenes.

Q. Sure. But you were -- you were portfolio manager of a public mutual fund. And you had -- you had a general understanding of what a financial advisor does, right?

A. Sure.

Q. And so these -- these calls that you mentioned, how often did you participate in -- in a, you know, so-called house call of that nature?

A. That varied over time. I want to say there was a time -- and the genesis of this was that some of the wholesalers were -- were becoming a little more insistent in their asking for some explanation. I was pretty well known for -- for not

wanting to be involved in sales marketing. I enjoy what I do as a portfolio manager. So I began to decline to take phone calls. So the compromise between myself and Catalyst was that they would hold periodic group calls to accomplish some of the Q and A.

At any rate, again, the frequency varied once a month, twice a month, somewhere in that neighborhood for most of the time that I was doing them, best of my memory.

Q. Okay. So when you -- a few answers prior when you mentioned that you threw out numbers on those house calls related to the scenarios that you examined an OptionVue, what were you talking about? What numbers did you throw out in the -- in the context of one or more of those open house calls?

A. So what -- again, you know, a lot of calls I have not done any particular review. I've heard some sound bytes played back to me in this process, but I've not done a thorough listen myself. A lot of calls. A lot of different questions and answers.

I remember talking about the risk metrics, as I explained them to you. In particular, the open option premium number, at the time, of 80 percent that we controlled to or tried to control to.

Page 53

Meaning, that was something that, you know, if we hit that number, we've got to take some action, or at least consider what action to take. But that was a pretty strict number for us to react to. I talked about stressing volatility in the Fund, particularly on the down side. Talked about, you know, taking some volatility through these assumptions.

I think I talked about multiples of -- of price movement, 5 and 10 percent maybe. But, again, my memory is not great. Lot of calls, lot of different questions. And -- and many of the questions were around strategy, some on risk. And sometimes I think those numbers change.

Q. All right. Well, putting -- putting aside what you -- what you may or may not have said on a particular call, let's focus on what -- what you, in fact, did, what your practice was in stressing the portfolio. And so were there -- again, we talk about the fact that, you know, for a particular combination of time horizon and -- and volatility change, OptionVue would compute and display the option portfolio value for a range of prices specified by the user; is that right?

A. Yeah. It would -- it would model -- again, it would model what the portfolio value might

Page 54

look like if all the assumptions came through. And, again, my experience is that at the end of the day, it's -- it's an option process in terms of option prices. So the option models are very useful, but they're -- they're -- they're not set in stone. So you have to have some judgment over time to understand how to use them, like any -- any model.

Q. But were there -- were there particular scenarios, default scenarios that you considered when stressing a portfolio in the ordinary course of managing the Fund?

A. There were default scenarios that the software would open up to, and that was typically determined by the furthest out expiration in the portfolio. But that's -- again, that's something I adjusted. I would typically look at individual expiration periods. I would -- very, very importantly, in OptionVue, it will actually compute the -- the current market volatility and give you a -- some stats on that, like a one-standard deviation move or a two-standard deviation move. Those are very helpful in understanding the current environment in a snapshot. Oftentimes I would look at them.

Again, always -- with any model, I think

Page 55

you have to do kind of a sniff test, I would call it. Say, Does this make sense? Does it got the right data? Can I check an ultimate source? So -- so default scenarios really depended on market conditions. Again, not -- some of the numbers I threw out in the calls were based on, you know, over a five-year period of time. Options volatility is 15 to 20. That means that a 5- or 10-percent move is a pretty good move on a 90-day period of time, and 90 days is a -- is a good portfolio. You know, that would be a typical excursion. We would -- we would -- the positions on as far as 90 days out. So it was a good example to use, trying to give people a sense for how I managed the Fund. But on any given day, I had to be a little more precise about where am I living right now? What's the portfolio look like? What's the market look like.

Q. Did you -- did you stress the portfolio in OptionVue on a daily basis?

A. I opened up OptionVue every day. There were some days in which -- not frequent, but there were some days, especially in a low volatility environment, where you could tell, I mean, the market was mostly unchanged. Yesterday the NIX was mostly unchanged. OptionVue is not going to give

Page 56

you a whole lot of different -- you open it up, you look at it, and there wasn't a need to go through, what I would call, a rigorous stress test with ten different scenarios.

But I opened it up when I looked at the curve, and I understood where the market was and used my judgment about what sort of in-depth stress testing I needed to do. But the portfolio, you know, graph was -- like I said, I didn't -- I didn't come to work on opening a budget.

Q. And so, you know, whether you did in-depth stress testing or you were opening OptionVue, and -- and you're looking at the curve, let me -- let me stop there.

You mentioned, you know, looking at the curve or the graph in OptionVue. What are you talking about? What is being graphed? Or what curve are you referring to?

A. It's the model prediction of -- of, in this case, if I open up OptionVue -- which I did, every day I looked at it. And, you know, the extent to which I did a stress test, again, depending on the environment. But I could look at it and immediately see under -- under whatever assumptions it opened up, what the -- what the portfolio value

would look like across different time horizons going forward.
Q. Okay. And if you opened OptionVue -- come into work, first thing in the morning, you open OptionVue, what -- where is OptionVue picking up from? What is it going to display to you?
A. Depends on what the portfolio looks like. Meaning, it will cue -- it's the follow-up cue off of typically the furthest out expiration in the portfolio. And, again, sometimes that -- that's the right thing to look at, sometimes not so much.
So, again, I would have to take a look -- and as I said, you know, that's -- that was my process. I would certainly take a look at it. But I would know coming in, in the morning, you know, what's our environment. You know, again, are we March of 2020? Are we in February of 2017? Or are we someplace in between? And that would determine how much time I put into, all right, am I managing risks today? Am I putting on new positions? Or -- or maybe I'm going to let time decay work for me, and today's a very good day to do very little or nothing.
Q. One of the things that OptionVue would display would be the impact on the -- on the

portfolio from increases and decreases in the level of the S&P 500 Index; is that right?
A. Yeah, the OptionVue screen would show you plus or minus, wherever you want to look really, in terms of S&P pricing, yes.
Q. Okay. And where would you look in terms of S&P pricing? Were there -- were there particular percentage increases or decreases in the S&P 500 that you were -- you were examining and considering in the ordinary course?
A. Well, I don't know if there is an ordinary course. In the -- the -- the current market conditions and portfolio composition are absolutely what drives that. Like I said, if I've got a big chunk of positions 90 days out, I'm looking 90 days out. If I have nothing out in 90 days, I'm probably not looking out 90 days, so depending on the portfolio composition. And then, again, if we're in a volatility environment where the likelihood of a 5-percent move in a week is one in a million, then I'm probably not looking at that scenario. So it's absolutely market environment and portfolio composition driven. And there's a big, big chunk of my judgment and experience rolled into that as well.
Q. Um --

A. It's simply not a mechanical system.
Q. All right. So with respect to increases and decreases in a level of S&P 500 Index, are you saying that what you looked at just changed from day to day, you didn't have any particular scenarios that you were looking for?
A. It didn't necessarily change day to day, because my experience is two things. Market environments don't change radically from day to day. In fact, it's rarely changed radically from day to day. Every once in a great while they do, but it's not the basic scenario. So in a particular market environment, you kind of expect that to persist.
And so if -- if there's a low vol or a high vol -- volatility market environment, then I would start looking at similar things every day until either the weight of evidence or the -- the statistics in marketplace would cause me to say, Hey, I better -- I better throw a different scenario in here now, because things are different. So -- so not every day. But -- and, again, the portfolio as well. Portfolio didn't change dramatically every day. But there were ebbs and flows in the material over time.

So on any given day, I would have to assess, all right, you know what, I've -- I've been scaling into positions in that 90-day expiration. I've got -- I've got what I would consider a full position out there. I've got to change some of my time frame scenarios. So, again, it's a very, very fluid situation. And it is a lot of analytics to determine what to do, but a lot of judgment in terms of how to use models and tools.
Q. Well, just sticking with -- with price for a moment. The scenarios that you examined, did they include 5-percent and 10-percent increases and decreases in the level of the S&P 500 Index?
A. Yes, I -- I recall on a couple occasions talking about those levels. Again, not wanting to in -- I don't know if it's effective in answering questions to go where my answer's designed to be a comprehensive and detailed manual for how I manage the Fund. It's -- again, it's not a mechanical fund. So those are very good approximations of the type of scenarios I looked at in a -- in the -- the average scenario for the Fund, but, again, it's only an average.
So it's -- it's not something I did in the low volatility environment, nor high volatility

Page 61

environment. It's something I did maybe in an average environment where the Fund had positions where that was appropriate. So that was a good -- you know, I think those were good tools to explain to people in a general sense what I was doing. But on any given day, it really depended on the position of the Fund and the market conditions.

Q. All right. So depending on the position of the Fund, depending on the current market conditions, you may or may not have examined what -- what the impact to the portfolio would be from -- from a 5-percent and 10-percent increase in the S&P 500?

A. Yeah, if there was a -- if there was a scenario where I felt like a -- looking at 5 or 10 percent out over -- you know, over a week. Did that make sense? Did the information tell me anything?

There was some -- there were times when that's not a scenario that's -- that's informative to me. And there were many times when it was a scenario that I didn't look at. But -- but, again, in aggregate, if you want to explain something to someone and use some general terms to give them a feel for what you're doing, those are good numbers.

Page 62

Q. But if I understand your testimony, those are not scenarios that you considered every day?

A. That's correct. I didn't consider those precise scenarios I wrote every day, no.

Q. Okay. Were there any -- were there any scenarios, whether on the price side or the volatility side that you considered every day or on a routine basis?

A. Yeah. I -- again, I've always considered price and volatility excursions that I felt were reasonable based on current market environment, current fund portfolio. Am I experienced with how options and -- options in my particular -- options spread behaved in those scenarios. So -- so, again, I apply my judgment in how I use the tool, which -- which plug to pull out of the bag based on which way the wind was blowing and how long a drive I needed.

Q. Yeah, and I hear you. But you're saying what was reasonable or what was judgment. And I'm trying to get a better sense of that. So was there a club that you pulled out of your bag every day or almost every day that you used, you know, that club being the analogy for a scenario, whether it be a price increase or decrease scenario or a volatility increase or decrease scenario? Or were there -- was

Page 63

there a particular club or particular clubs that every day you reached into your bag and you pulled out and you used in stressing the portfolio? That's what I'm asking.

A. Yeah, I think the -- the better way to put it is every day I pulled out a club, and every day I had my bag. Every day I had a swing at golf. I had my bag and I had a club, and I pulled one out that I felt was the right one for the situation.

So if you -- if you ask me -- again, I'm -- I'm a little uncertain why I'm going down the golfing analogy, because I don't golf. But I know that, you know, I -- when I step up to the tee, I'll use a driver of some kind, I guess. But depending on the hole, depending on the -- the conditions, I might use a different driver than the day before.

And if someone asks me, I would say, Yeah, you know, a lot of times this one's -- this one's a good one. And just to have you understand that I use the driver when I'm off the tee.

Q. Okay. Well, I'm not going to go down the golf analogy further. It sounds like neither one of us are big golfers. But focusing -- what I really want to drill down on, sir, is whether there were particular percentages. We talked about 5 percent,

Page 64

10 percent, and upper increase or decrease in the S&P 500 Index. And on the ball side, were there particular point increases or decreases that you considered on a daily basis in OptionVue?

A. I mean, the best answer I can give you is -- is no. At the risk of being overly repetitive, I don't mean to be, it's -- it's absolutely -- I mean, I don't think it would serve anyone to have a mechanical locked in set of parameters like that that don't make sense in a particular environment.

Like I said, if -- if I said to you, I'm gonna stress a 1-percent move every day, and all of a sudden we're in COVID, that would be foolish. That would be the absolute wrong stress test to use. And if I said to you, Well, we just came out of COVID, I'm stressing 5 percent down tomorrow, well, then that would be a treasure the whole time. I would never look at anything. So you -- I think it's -- as a portfolio manager, it's irresponsible not to select the right -- the right methodology. At least to the best of my experience, the right methodology to use, given the portfolio composition, given the market environment, and that's what I did.

Q. Okay. So to circle back, you gave me --

Page 65

you gave me your explanation for -- for why your answer's no. But the answer's no, if I understand your testimony. There was not a -- there were not particular increases or decreases in the S&P 500 Index or a particular point decreases or increases in options volatility that you considered regularly or on a daily basis?
MR. KOPECKY: Objection. Form. Foundation. Mischaracterizes the testimony. And it's been asked and answered. But particularly with the use of particular, because there was always a particular number, just not the same particular number the way I understood.
Go ahead and answer then.
A. Sure. So, again, I mean, I -- I have to give you some context about -- around the answer. I don't want to be misinterpreted. Each day I would use --
BY MR. FOSTER:
Q. Yeah, if I could stop you there.
I think you gave me the context, and I'm asking if you can answer the question yes or no. If you can't, then I guess you can't. So my question would be --
A. I --

Page 66

Q. My question would be -- and I'll -- let me know if you want me to restate it.
My question would be, yes or no, were there particular increases or decreases in a level of the S&P 500 Index that you considered every day in -- in looking at the portfolio in OptionVue?
MR. KOPECKY: Same objections.
A. And I -- I have to repeat the same thing. I -- you know, I -- honestly, I want --
BY MR. FOSTER:
Q. Don't repeat -- don't -- sir, don't repeat what you said.
Just are you able to answer my question, yes or no?
A. Mr. Foster, I -- I -- again, I apologize. I'm doing my best to be cooperative, but I cannot take the chance that I give you a misleading sound byte kind of response here when your question requires the context I've given you, and I have to repeat that.
Q. No, you don't have to repeat it, because I've -- you don't have to repeat it, because I've heard it. I've heard it several times now. And -- but what I haven't heard is an answer to my question, which is whether or not -- so I have the

Page 67

context, but it's simply whether you did or did not do something. So did you look at particular increases and decreases in the level of the S&P 500 Index in OptionVue every day --
A. Every day -- every day I did look at particular increases and decreases, and --
Q. Okay. When I say particular -- when I just say particular, I mean the same. So a common percentage. So 5 percent -- let's be very specific.
Did you, on a daily or regular basis, examine a scenario that included a 5-percent increase or decrease in the level of the S&P 500 Index? Did you do that in OptionVue either on a day -- every day or almost every day when you were stressing a portfolio?
MR. KOPECKY: Objection. Form.
A. On some days, that -- the level that I looked at was 5 percent. On other days, it was not.
BY MR. FOSTER:
Q. And what about the 10 percent level? Did you -- was that a level that you looked at every day?
A. On some days, 10 percent was the level -- level I chose, because it was the appropriate one. But on other days, it was not.

Page 68

Q. Okay. What -- you said some days. Are you more or more often than not? Are you able to -- are you able to tell me how often you looked at either the 5-percent increase or decrease or the 10-percent increase or decrease in the level of the S&P 500 Index?
A. I -- I can't speculate on a particular, you know, percentage of the time. Those numbers were the right numbers.
Q. Were those numbers -- whether you were focused on them or not, were those numbers -- was that information graphically displayed on the OptionVue graph curve that you -- that was -- that was visible to you when you opened OptionVue?
A. I'm not sure what you mean by whether those levels were graphically displayed.
Q. Well, you open -- tell me, sir, what happened? You opened OptionVue, what -- what's the first screen that pops up when you open it?
A. Well, the first screen that pops up is a -- I think OptionVue calls it a matrix. It's basically a, quote, listing of all the different markets and indexes and securities that I've selected to appear.
Q. The matrix screen -- I'm sorry. The

matrix screen is the screen that allows you to enter information about trades that you've made or that you're considering making; is that right?
A. No. The -- the initial screen you asked about -- and I may be incorrect labeling as matrix, but it's simply a listing of quotations, some volumes test.
Q. How do you get to a screen that includes the graph, the curve that you're referring to?
A. So if I -- if I wanted to look at options related to any of the securities or instruments that were on that initial page, I would click on it. I -- you can click on the particular instrument. In this case, it would be S&P futures.
Q. Okay. But would you -- would you view the graph every day? Would you click on it every day?
A. Yes. Every day.
Q. Okay. When we're talking about increases or decreases in the level S&P 500 Index or changes in volatility, again, the -- when you're accepting that -- those -- those factors, you're accepting how they would impact at a given level, how they would impact the portfolio, correct?
A. I'm sorry. Can you repeat that?
Q. Sure. The scenario -- on a day when you

considered or examined, you know, what would happen if the S&P 500 Index increased 5 percent, right, what -- what you're -- what you're looking for is how that move in the S&P 500 Index would impact the portfolio holdings, the option futures holdings that you -- were in the portfolio, correct?
A. Yes. So I'd look and see what, again, the standard you asked about the -- what screen pops up. Well, the screen would typically pop up with five different time frames. And so I would look out and -- and -- and the X axis, if you can visualize this, was simply the price levels on the S&P. And the typical pop-up screen, I don't know, I would have to go in and set how wide an X axis I want it. And, again, that would be dependent on how far out the portfolio's positioned. So I could look at whatever I wanted, and the X axis basically -- S&P futures, front month futures pricing.
Q. What you're looking at is how -- how these potential change -- how the potential change in market conditions might impact the -- the value of the portfolios, correct?
A. Well, I would look and see what the -- again, what -- what the curve looked like at various points, plus or minus where the mark was today,

pricing the S&P futures, yes.
Q. All right. But in looking at the curve, what are you looking for? Are you looking for anything in particular?
A. Well, remember, there's -- the default is the five words. So I'm -- I'm first selecting which of the five, if any of the five, make sense to me. And each of them would have a different result or different prices on the S&P and -- and would give me a model value of where the portfolio might be at that price. If nothing about the model inputs change, which, you know, on its face, that's -- that's kind of an impossibility, because -- well, at least I've never seen a market move without some of the inputs to the model changing, sometimes pretty dramatically. So snapshot of -- of five different time frames, five different curves, as many prices as I want to look at for -- for wherever the portfolio might be, or where a particular expiration series might be. Anything I want to look at. Again, it's -- it's a tool with a lot of different uses.
Q. Each -- each curve, each line, you mention five lines, so essentially there's five curves by default, correct?

A. Correct.
Q. And each -- so each -- each curve represents a range -- or forecasts a range of portfolio values based on a range of -- of moves in -- in -- or based on a particular scenario of price and volatility, correct?
A. Yeah. I mean, maybe the technical language you used isn't quite correct. But each curve matches up a point of value of S&P price and time. And, again, with the underlying assumptions around skew and aggregate volatility, which are either set by me or default to the model or some or both.
Q. So each one of those curves represents a particular scenario of time, volatility, and -- and potential price increases, right?
A. Yes, or decreases.
Q. Or decreases. Right.
And so for each one of those scenarios that the -- that the five lines depicted, did you consider whether that scenario involved the loss of more than 8 percent of the Fund's value?
A. Well, typically the first thing I did was try to determine if I had the correct scenarios displayed before just looking at them. Meaning, was

I looking at the right time frames across those curves? Did I have the scaling set so that I can see, you know, the right range of S&P prices? And then it gets back to what I've talked about. I apologize for beating it to death, but it's just I don't know how to explain what I did other than to keep repeating what I did. And that is I'd take a look -- and OptionVue helps you.

In other words, at the bottom of this exact S&P prices, it will give you a display of current market volatility and standard deviation movement. First thing I have to view is double check that it's got a reasonable input number to display that. And then it gave me a decent guide for price ranges. But, again, it's timed to it.

So I look at my portfolio. Say, where -- where are my positions? Where -- where is my risk? Where is my opportunity? What time frame should I look at? So I would then go in and adjust all of those parameters to make sure that they were reflecting something useful, some useful outputs. I can't -- you know, my experience with this made it at least a little bit easier to -- to come to that point. But I can't just open up OptionVue and look at something if it's not giving me useful

information.

Q. Mr. Walczak, did you use -- did you ever use the OptionVue software to estimate whether there was a scenario that involved a loss of more than 8 percent of the Fund NAV?

A. Yes.

Q. How often did you do that?

A. Again, most every day. And I'm going to qualify with most, because, as I said, in certain environments, there was very little change day to day. So if I saw something yesterday, I could pretty immediately tell that nothing material had changed. So I continue to act on whatever I had seen. But for the most part, I looked each day, and I -- I looked at that level that's a level that I chose long ago and talked about both primarily in terms of OptionVue.

And that's what OptionVue is -- is telling me. Really the way I used it is what's the open option premium value in the Fund? So I looked for -- for scenarios where that 8 percent number was triggered.

Q. Okay. So just so I -- I want to try to really drill down on that to make sure that we're -- we're clear, that your testimony's clear. When you

talk about, you know, that 8 percent number, that's the number that you used, you used OptionVue to estimate whether there was a potential -- whether there was a scenario that involved a loss of more than 8 percent. My question -- I said 8 percent of the Fund NAV, but correct me if I'm wrong. When you say 8 percent, what are you referring to? 8 percent of what?

A. So I used the 8 percent option --

MR. KOPECKY: Sorry, I don't want to cut you off. I just want to make sure we know in what context you're speaking.

When he just answered your question, what do you mean when he said 8 percent? What context are you talking about? Is there a specific time? You said 8 percent. You can ask him about that. What he meant when he -- when he used the term then. But let's not just generally decide that every time he said 8 percent it meant the same thing. That wouldn't be true.

MR. FOSTER: I'm not sure I understand your objection, but I'll --

MR. KOPECKY: In what context do you mean -- when are you asking, What did you mean you used the term 8 percent? Like, you told us, I'm

talking about 8 percent --

BY MR. FOSTER:

Q. Sure. I mean -- I mean -- I mean right now. I mean when you just said that you knew that that was the number you arrived at long ago. That's the number that you -- you looked at that you -- that most every day you were looking and assessing this 8 percent number. What -- 8 percent of what? What are you talking about?

A. Yeah, the primary number I used, because I felt -- you know, again, I've been using this for a long time. It's a -- it's a good simple number that doesn't involve lots of more complex calculations. It's simply how much open option premium exists in the Fund. And that means this is what you have to spend in terms of fund assets to -- to go to cash essentially.

And so the 8 percent number in OptionVue, I used the setting that had OptionVue displayed a value of options instead of P&L. The value of options, and I looked -- you can always find the scenario where there's an 8 percent loss on some time frame or some pricing. So the question then becomes: Is that even a scenario you should consider? And, like I said, if you expect

1987 Black Monday to happen tomorrow, then you better be in treasuries all day long.
So you have to consider, again, based on a marketing environment, what is likely. And that was the judgment on my part about likelihood based on market environment and based on portfolio composition. So, sure, I would look in most cases to see where there was an 8 percent potential. And most of the time I could immediately throw that scenario out the window and say, This is the one in a hundred. And I'm not going to react in this moment's one in a hundred, like --
MR. FOSTER: So we've been going about an hour and 45. I don't know how you're doing, Ed, how the court reporter is holding up. What -- what do you think?
THE WITNESS: I could probably take a bathroom break at this point.
MR. FOSTER: Okay. Let's do that. What do you folks want? Ten minutes or so?
THE WITNESS: Sure.
MR. KOPECKY: How about let's stick to the -- to the ten solid, and try to make -- try to keep it that way. I was joking earlier that every time we take a 5-minute break, it's 10. When it's

10, it's 20. Let's -- let's say 10 minutes solid, we'll be back?
MR. FOSTER: Sounds good.
MR. KOPECKY: All right. Thank you.
VIDEOGRAPHER: We're going off the record at 11:22 a.m.
(Recess taken.)
VIDEOGRAPHER: We're going back on the record at 11:34 a.m. Okay. You may proceed.
MR. FOSTER: Thank you.
BY MR. FOSTER:
Q. Mr. Walczak, a few moments ago, we were discussing the fact you had a practice of looking in OptionVue for an 8 percent figure. And I just want to better understand what you're talking about, what that 8 percent relates to. Is it -- is it a 8-percent decrease in the value of the options portfolio? Is that what you were referring to?
A. No. When I -- when I look at OptionVue is the value of the options position, and I'm looking for a net short options value of roughly 8 percent of the portfolio.
Q. And you mention an 8 percent as it related to open option premium. Is that -- is that something different, or is that the same thing as

you just described?
A. That's the same.
Q. All right. So maybe just indulge me a little more. Just -- when you say open option premium, can you sort of break down, tell me, explain to me what you mean?
A. So open means positions that are open, not closed out. They're existing positions. And the sum of the value of those positions, if they're short options, which is the scenario we're looking at, that means they have a negative value. It cost money to close them out. When that value -- the scenario I'm looking for is when that value is going to be 8 percent or greater than the total assets in the Fund.
Q. Okay. So does that mean you're looking for a scenario where there's -- there would be an 8-percent drawdown of the Fund, or is that something else entirely?
A. I thought over my experience that the two were very similar, because it was typical for me to enter positions, what's called an at even. Meaning, I would spend a certain amount of money on the long side of the position and take in a roughly equal amount on the short side of the position so that at

the end of the day, if there were -- if the Fund were all in cash, and I put a position on it, you would see a zero net open option premium. And if that open option premium grew to 8 percent, that was a pretty good approximation of decline in P&L on the Fund. And as I said, for -- for risk control purposes and for monitoring the Fund's posture, that was a good aggregate, relatively simple to model measurement that I used.
Q. Okay. So the -- the 8-percent drawdown, when we were just talking about drawdown, what -- how do you define drawdown?
A. So the way Catalyst suggested that we define it was 8 -- 8 percent change on a rolling months basis, I think, is the way that they set up the risk metrics.
Q. Okay. But in OptionVue, when you're looking for 8 percent, if I understand it, you're looking -- you were considering, you know, scenarios that would result in an 8-percent negative net decrease in -- in the value of the Fund, right?
A. I was -- I was looking for scenarios that -- that would cause the Fund to have 8 percent or greater in open option premium.
Q. But, again, how -- open option premium.

How is that different than what I'm saying? If I'm -- if I'm saying that you and Mr. Walczak were looking or considering scenarios that would result in a 8-percent decrease in the Fund's NAV, am I wrong?

A. Well, all I can say is I didn't do fund P&L calculations in OptionVue or at all for that matter. So I can only look at the next day's print and assume it was correct. Occasionally if it looked off, I would raise a flag, but I didn't do fund P&L coverages.

Q. But I think I heard you to say that the 8 percent open option premium would be -- would -- would translate -- would typically translate roughly to -- in 8 percent. If it was in excess of 8 percent open option premium, that would translate roughly to an 8-percent decrease in NAV?

A. Yeah, it should be somewhere in that neighborhood. Again, because we entered positions at zero. So, again, a lot of other things went into NAV, but it was good portfolio management level risk control I thought of at the time.

Q. Did OptionVue measure open option premium as -- as a default setting?

A. It -- it measured the value of the

positions that I entered, which were the positions of the funds. It measured the current value based on either a settlement price or it would take the bid offer in marketplace and calculate the value of the open option positions.

Q. Okay. So it -- would it calculate it for you, or is this something you had to adjust or do an OptionVue to measure open option premium?

A. Well, again, it goes back to -- I mean, it would calculate it in -- in real time based on whatever settings I put in, which there were a role handful of settings about how you wanted to calculate it. Because, again, even the model recognizes that option pricing is based on an option market. So you have to say, Do I want to take the last price, trade it? Do I want to take the bid price currently, the offer price currently, some combination of all those things? So I happen to choose the midpoint between the bid and the offer. In those settings, OptionVue would add up all of the -- the option prices in that aggregate value of the portfolio in terms of open option premium.

Q. Okay. You identified a scenario that involved a -- if I'm -- if I'm saying this right, a net -- a net short open option premium value of an

excess of 8 percent?

A. Well, as I said, every day I open OptionVue, sometimes immediately see one of those. And then I would have to decide whether that was a reasonable scenario. As I said, if it -- if it was a look if we decline 10 percent tomorrow, we would be down 8 percent in the Fund, I would say, Well, that's not meaningful to me. I'm not going to look at that. So -- so that was how I used the model is to identify meaningful scenarios based on market conditions and further -- further construction.

And if one of those scenarios was in excess of 8 percent, I would then figure out what's the best course of action, sometimes nothing, but what's the best course of action to take in light of that identified risk. But 8 per -- 8 percent was the line that I -- I used to even take a look at it and say, Do I need to do something here.

Q. Okay. And then in what -- in what conditions would need to exist for you to take some action based on that 8 percent number?

A. If --

Q. Versus -- versus not taking action?

A. Well, it would have to be a scenario that I felt that in -- again, in my judgment was likely

enough, and it's to a large degree of a judgment call. But I like to use probabilities and -- and ranges of potential market movement to determine, look, is this a -- you know, a -- is this a conflict that we're going to get there? Is this a 1 in 10? Is it a 1 in 100? You know, a 1-in-100 scenario, likely throw it out. I would not even look at it. 1 in 10, I'd -- I'd take a closer look.

And, again, this is a -- this is a -- a -- this is a very judgmental thing. It's a -- it's a model that -- and my judgment gets taken into account in terms of what -- all these factors I keep repeating, portfolio composition, market conditions. And -- and some likelihood -- it's a risk-and-reward balance, which is I think what, at least what I do, as a portfolio manager.

Q. So were there times that OptionVue should have lost more than 8 percent of portfolio value at stress points, and you were considering and you did not adjust the portfolio composition to eliminate that -- that risk?

A. Yes. As I mentioned, every single day, you can find a time and price combination that would give you -- many time and price combinations that will give you an 8 percent or greater loss. And so

Page 85

there were many times when I determined that that was a highly, highly unlikely scenario. And at least unlikely in terms of my judgment of risk and reward and that I would elect to, either nothing specific about that risk, or do nothing knowing that over time the risk comes off, or, you know, that no specific risk mitigation action was necessary in that particular time frame or in that particular scenario.

Q. Did OptionVue give you information about how probable a particular scenario was?

A. Well, as I -- as I said, I took into account current market volatility. So there are -- you can do some fairly easy statistics on, you know, standard deviations of movement based on volatility levels and standard deviations to give you probabilities that's a, you know, status one-on-one kind of textbook table you can find in a lot of places. One -- one standard deviation carries a certain probability that whatever you're measuring will stay within a certain range. So that's the kind of the thing I used, so it wasn't a pure, Hey, how do I feel about this? There's certainly some math involved as well. And I depended on that to -- to be a guide.

Page 86

Q. Well, walk me through the steps there that you would -- you would undertake to determine whether a particular scenario that involved a loss in excess of 8 percent in portfolio value was likely or unlikely.

A. Well, the first step was to -- you know, you open up a -- you open up a chart saying, Is the market then trending higher? Trending sideways? Trending lower? And then you say, How -- what kind of range of movement have we been experiencing? That's where you can measure market volatility. So I would -- OptionVue calculates this. It -- it assembles a 20-day, 20-trading day lookback period, which is fairly typical, in my experience. And would compute a, you know, statistical distribution on that. And -- and, like I said, then you use -- you've got a one sigma, two sigma, and you can -- you can kind of tell it will give you a probability. And there's no certainties obviously, but it will give you a mathematical guide that helps.

Q. Okay. Was there a particular probability in OptionVue that -- that would, you know -- that would prompt you, then, to take action?

A. Yeah. I mean, again, just a rule of thumb that I liked to use was a one-sigma move or what --

Page 87

whatever time frame I was looking at for a couple of reasons. My -- my experience with -- with actual options behavior as opposed to simple models is that upside movement tends to be bounded in -- in the vast majority of cases by a one-sigma upside move. Again, that's my experience and my judgment. But that's -- that's what I use.

And downside, actually, two sigma or sometimes greater, so a fat left tail. So -- so I use those kind of guide. It helps. So whatever time frame I was looking at, you know, what's a one-sigma move. Now, even in a random scenario, a one-sigma move to the upside is a 1-in-5 kind of probability, maybe a 1-in-6, maybe a 1-in-7. I can't remember the stats off the top of my head. But in my experience, again, the -- that upside boundary was a pretty good level to look at.

Q. When you say one-sigma move, does that -- does that equate to one standard deviation?

A. Yeah.

Q. And in determining or assessing the 8 percent, if there's an 8-percent decrease in portfolio value, 8 percent of what number? Where did you get the number every day to determine whether that 8 percent threshold was exceeded or

Page 88

not?

A. Basically at 8 you'll have one of the Fund or whatever account I'm trading.

Q. Okay. OptionVue showed that there was a scenario that resulted in a decrease of an excess of 8 percent of portfolio value. That's something you would have been aware of that that was -- that was visually presented to you in OptionVue?

A. Yeah. Again, every day I could see multiple examples of that scenario. I could adjust the input settings and see more or less those scenarios. I had to choose whether or not those scenarios were likely enough to -- to take action. That's really what the stress test was about.

Q. Okay. And when we're talking about the standard deviation, the one -- one-sigma move or two-sigma move, are you -- were you using OptionVue to make that calculation, or were you calculating that -- that standard deviation by some other method?

A. Sometimes both. As I said, OptionVue collects the data, as with any model. As I mentioned before, you would have to take a look and say, Does that seem right? And, again, in a -- in a low volatility stagnant-type of condition, you know,

Page 89

you know kind of what to expect. And especially you don't -- if OptionVue, for example, changed their number dramatically from one day to the next, I would be suspicious and perhaps there was a little bit of a data hiccup or the calculation lookback period was incorrect. So as I also mentioned, go back and it was publicly traded or publicly published indexes of realized volatility trailing 20 days, as I said, that's a standard period. And so that's a good sort of litmus test to make sure OptionVue is doing the number right.

Q. All right. Can you take me through the specific steps, including the data that you used when calculating the standard deviation outside of OptionVue?

A. Well, again, most of the time I would simply go to a published index. But it's essentially you assemble a -- you do it with Excel. I haven't done it in a while, but an analyst do it for me. It's just like in the world of calculators where you forget how to do math in your head. I don't know that -- that here today I can quote a calculation or an Excel formula, but it's a statistical distribution of closing prices on, in this case, the S&P. And oftentimes we use the cash,

Page 90

because the data's a little cleaner than a future's contract, and they're related. They're ultimately funded obviously. So you do -- you simply do a database of 20 observations, and you do a standard deviation calculation. And then once you -- once you understand the standard deviation, you have your sigma, and you do one sigma, two sigma, three sigma.

And, you know, the standard probabilities, which, top of my head, a one sigma is a 66 or 67 percent of the distribution, which, when you do it in one direction, it -- you essentially have a 16-percent chance on the upside of receiving one standard deviation. And 16 percent on the downside. So you have these standard mathematically sound calculations that can be performed. That's related typically. As I said, that's -- that's with OptionVue would actually put a range at the bottom of the chart. And my job was just to -- just to make sure there didn't seem like there was something off with the OptionVue calculations, so I would periodically check outside sources.

Q. How often would you do that? How often would you try to verify or audit the information in OptionVue with respect to the standard deviation?

A. Whenever something didn't seem right to

Page 91

me.

Q. And how often was that?

A. I can't really put a -- can't really characterize it. I don't know. Again, I hope on OptionVue, if -- if a number had changed dramatically and I didn't see a reason for it to change or something just looked a little bit off to me, I would double check. And that's -- that's the same with any of the inputs to the models -- to the model.

Q. But if something didn't seem off to you, you wouldn't -- you wouldn't undertake that exercise; is that right?

A. Right.

Q. When you mentioned -- in doing the calculation outside of OptionVue, you talk about, you know, 20 different data points. Does that mean the last 20 closing prices of the S&P, or what were you referring to?

A. Yeah, less -- 20 closing prices of the S&P would be a typical -- as I said, a 20-day lookback, which is essentially a month. I think maybe some -- to be more precise, the average month might be 21 one day. So it's -- the idea is to have a month lookback to say, Here's -- here's our environment

Page 92

over the last month.

Q. How did you typically stress the portfolio in a -- in a low volatility environment?

A. Well, I -- I stress the portfolio pretty much using the same techniques I described, regardless of the environment. The environment was important. So if it was a high volatility environment, your standard deviation of price movement is -- is going to be much larger than a low volatility environment.

In a high volatility environment, you can start to make some assumptions about changes in volatility. Low volatility environments tend to persist. High volatility environments tend to mean or hurt to lower volatility environments. That's my experience in terms of equity markets. I think there's some -- some kind of -- but it's my experience.

So the environment is what it is. And I would stress it from a price standpoint accordingly. From a volatility standpoint, you know, high volatility environment tends to mean reverse. You want to stress or decline volatility. But high volatility environments, especially to the downside, can get even higher. You know, so it's like trying

to bottom pick in an equity decline. You don't want to top pick a volatility.
So if volatility's high, you're actually stressed to get even higher. If volatility is low, in my experience, you probably assume no change. And if volatility's high on the upside, you -- my technique was to stress a decline in volatility and see if that had an adverse effect.
Q. Okay. Then how would -- what would you consider defined to be a low volatility environment?
A. Oh, I would say -- I don't know if you want to use the stats. Annual -- annual volatility of 15 and less, maybe, is a low volatility environment. 15 and higher -- maybe 20 and higher is high. Normally it lands at 15 to 20. Those are good ballpark numbers, but...
Q. All right. Why don't we -- why don't we circle back for a moment to a little bit of the nitty-gritty of how OptionVue works. So I'm going to move into the marked -- you marked exhibit folder. Well, I guess you have -- you have the documents outside of Egnyte, so let's look at the next exhibit, Exhibit 2.
(Exhibit 2 was marked for identification.)
A. Right. Here's my first test.

BY MR. FOSTER:
Q. All right. Bear with me for one moment as I am going to move it into Egnyte as well. So we're not so -- do you have Exhibit 2 in front of you, sir?
A. I do.
Q. Okay. And this is an e-mail from -- the first e-mail at the top of the document of the exhibit is from you to Mr. Schoonover and others, dated March 5th, 2017. Do you see that?
A. Yes.
Q. Okay. And just for the record, Exhibit 2 has a -- first page Bates stamped SEC_01_0000524.
Do you recognize this document?
A. I can't say I recognize it. I have no reason to believe this is not an e-mail from me, but I don't remember it.
Q. Okay. Well, take a moment to look at it. And this is -- this e-mail includes several attachments, correct?
A. Several attachments to the documents I'm looking at, yes.
Q. Okay. And are -- are two of those attachments examples of the graph in OptionVue?
A. Let's see. It's flown all the way down.

I see the side points -- I still recognize them to be -- at least four of them to be it looks like OptionVue.
Q. Okay. And I don't want -- I'm not focusing on -- this is on the -- on the particular date in which these were sent or the information on these particular OptionVue graphs. But, you know, if I'm understanding the e-mail, this OptionVue graph reflects -- there's two different graphs. And in the attachment line, one's -- one's labeled, Existing Mar 3rd close, and the other -- the other is, Graph Proposed Mar 3 close.
Do you see that on the first page of the document?
A. Are you talking about in the e-mail?
Q. In the e-mail, yeah. If you have the header information, there's descriptors for the attachments.
A. Okay. Yeah, I see the descriptors. I'm not good at figuring out pings and images, so I'm not sure what it refers to, but there's some attachments there.
Q. Okay. Well, take -- read your e-mail and see if you can tell me what you were writing to Mr. Schoonover, what you understand this e-mail to

be sent.
A. I think -- let's see, if this is in March -- you know, it's back in December when Catalyst became pretty active in, you know, managing the Fund. So we were doing a lot of collaborative stuff where I was asked to provide some scenarios back to the Catalyst risk team investment committee about -- you know, basically, share with them some what-if scenarios. So it looks like that's what I'm doing.
Q. Well, just to orient you the way we put this Exhibit 2, it's -- so the -- there is -- as you can see, there is -- in the header, there's two PDFs that -- that, you know, say risk graph. Or one that says, Risk Graph Existing Mar 3 close. The other one says, Graph Proposed Mar 3 close. If you scroll down to the bottom of the document, those two attachments are -- are sort of repeated, because the -- for ease of this discussion, we included the native color version. So with respect to -- if you go to Bates number SEC_01_0000528, the next page is in the exhibit. The same -- it's the same graph. It's just now in color.
A. Okay.
Q. Do you see that?

All right. So let's focus on -- let's focus on that page of the exhibit for a moment.
A. They --
Q. You can color --
A. The color graph, is that what you mean?
Q. Yeah. Page 8.
A. Okay. Page 8, okay.
Q. Of the -- of the PDF, yes.
A. Yep. Got it.
Q. All right. And if you would -- you should be able to rotate it clockwise, so you can --
A. Okay.
Q. Okay. Does the information displayed on -- on this page of the exhibit of 2, does this look familiar to you?
A. Honestly, no.
Q. Well, not -- not the precise data. But I'm talking about the OptionVue screen.
A. Sure. The screen is -- certainly looks like an OptionVue screen.
Q. Okay. Is this the screen that you would -- you would typically see in OptionVue when you used OptionVue?
A. This is what our screen looks like, yes.
Q. Okay. And is this the -- is this the

screen that would -- would pop up when -- when you first opened OptionVue in the morning, this particular screen?
A. No.
Q. Okay. What screen would -- would open up for you when you go on OptionVue?
A. The one -- the one whose name I think I'm miscalling securities of -- securities and index quotations is what pops up.
Q. But this is the screen that you would -- you would access as well?
MR. KOPECKY: Are you looking at the vertical -- the risk of vertical access profit loss? And if I understood his testimony earlier, maybe I didn't, so you can ask him that, but, no. When you show him something that quick and he doesn't have time to review each of the different options selected, I just -- I object to that.
So, Ed, take your time. Check all the different ECXs you typically used, you talked about, et cetera, et cetera.
A. Yeah. Sure. I mean, as I said, this is -- this is the screen I look at every day. So the format is exactly what I look at in terms of the visual representation of curves. This one happens

to have four curves instead of five. Typically it opened up to five, and I would decide if I needed one, two, three, four, five, depending on what I was looking at. This one, also, I noticed is using profit and loss, which is not something I used, because, as I said, I didn't keep up P&L in OptionVue. I'd look at values. So I'm guessing that, again, Catalyst had asked me to model some -- some scenarios. And, I do recall, they -- like profit loss statements and books, so apparently, upon speculating, looking at some of the parameters here that this is something they asked me to do. And I did it and shot it back to them, because I -- I don't think they used OptionVue. It looks like -- I think they used the first.
But these settings are a little different than what I would look at. Most predominantly the profit and loss, because that's not -- not without keeping the accounting, that's not actually accurate. It's more a generic, you know, here's a general direction of the Fund.
BY MR. FOSTER:
Q. Well, can you tell me what the vertical green line represents on the graph?
A. Vertical green line is current market

price. And, again, depending on -- this thing looks like -- oh, it's in -- well, it's in a back trader mode. I can see that at the top. And that means it's looking back in time at some point. So whatever time it's looking at, the green vertical line is today or current time. Or, I'm sorry, current -- current price at whatever time you've set the -- the model for.
Q. Okay. Is the model here set for March 3rd, 2017?
A. By looking back per year, it's set for 11:30 in the morning on -- on March 3rd.
Q. Okay. Describe -- can you tell me what back trader is? What is that?
A. So OptionVue -- one of its features is it collects -- let's see, today I think it does a 15-minute interval. Back at that time, maybe 30-minute intervals. It collects actual market prices, bid offer prices on options, and stores them so that if you want to go back and say, What would have happened if I did X, Y, or Z six months ago, knowing there was a big market crash or something you want to test, you could go back and test that and model it using actual market prices for whatever you were testing.

Q. Okay. So you --
A. Still a model. But you were using actual options prices, for example, to enter a position at that moment in time.
Q. So using the back trader function, you could go back to a past date and time and analyze the position or portfolio using the market data as of that date?
A. Yes.
Q. And OptionVue includes historical market price data, then, I assume?
A. Well, if you buy it, which I did, yes, it does.
Q. And how far back does OptionVue's historical market price data extend?
A. You know, I don't recall. They change data sources over time, just did a change recently. So that changes, you know. I want to say they go back at least ten years, but I'm not certain.
Q. And here the -- the back trader date of March 3rd is the same date as the e-mail, right? The e-mail is actually March 5th, right? So this was -- and the e-mail is as of -- is Sunday, so this is the prior Friday. Does that seem right to you?
A. Yeah, it's -- it's hard to tell from

looking at this estimate.
Q. Okay. And the vertical green line, that's something you would see when you opened OptionVue and looked at this -- this type of graph. That's something that's always there?
A. Yeah. I think there's -- again, as much as I use this, sometimes I forget what settings are there and what settings aren't. I think you can remove it. But in a typical I would use it, you would open it up and get a vertical green line. You have to be a little bit careful if you're opening up a futures contract, because a futures contract -- each contract month is separated by as much as 10 bucks, so sometimes OptionVue will prematurely grab the next contract. So you have to watch out, as I mentioned. There's a number of things that you have to watch out for with any model to make sure it's giving you what you think it's giving you.
But short answer is yes. That's a -- that's a typical way to designate where, I would say, market price. And today being whatever time you set it for if you're going historical.
Q. Okay. And does -- does the box that -- on the -- towards the bottom left of the screen that says, WAND, does that correspond to the green

vertical line? Does that represent the same information?
A. I guess it does. That will tell you precisely. Rather than squinting at the graph, it would tell you precisely where you have the green box located, because you can remove that green box.
Q. Okay. And there's -- there's a large black dot that sits on the point where the green vertical line meets one of the dotted lines.
Do you see that?
A. Yes.
Q. And what -- can you tell me what that -- the black dot represents?
A. That's typically the market price of whatever set of positions you have loaded in there. And that's an important number, because that's the actual -- if you're using real data in OptionVue, that is the actual market price. And sometime -- and the curves are the model's estimate of what's going on. So sometimes there's a -- and it's one of the -- one of the ways I would use to -- to check the model. If that black dot is not sitting on the curve, that would suggest that the model is predicting something right now, right here, that's different than what prices people are agreeing to on

the exchange. And so that suggests maybe you've got bad inputs to the model, or the real people trading are -- are -- their behavior is different than what Black-Scholes thinks it should be. That kind of thing. So the black dot is -- is actual prices. The curves are what the model thinks they should be.
Q. Okay. So here in this exhibit, it would be the current value of the portfolio, the -- this March 3rd, 2017, date where it meets the T+0 dotted line?
A. Well, I -- my portfolio, I don't know what's -- what's in here. I'm guessing it's some --
Q. The -- yeah. So -- so let me back up there, then. What's the -- the information in the -- the box immediately above the -- the graph?
A. It's not all displayed, because there's too much of it, but that tells you exactly what positions are -- are being modeled.
Q. Okay.
A. So that might be an old portfolio. It might be a single expiration period, for example. But whatever you've selected to model will appear -- the positions will appear up in that box.
Q. When you view this graph, were you -- were you -- was it your practice to view it for the whole

portfolio?
A. Sometimes the whole portfolio. Sometimes an individual position. Sometimes a position that I was contemplating putting on. Sometimes a portfolio plus that position. Some -- you know, any scenario that I wanted to model, that's what I would look at and I would select that with the -- the parameters I was able to select in all.
Q. Okay. Understood. But would you -- would you look at this graph for the -- the -- for all the positions you had on in the ordinary course every day?
A. Yeah. That would be what I would typically open up to. And then just I sort of drilled down what I needed to do or what else I needed to model. So that -- that's typically what I would open up to, to look at.
Q. Okay. And then -- so there -- as you noted, there are four different lines here. And do those lines correspond with the -- the legend or the box that's overlaid the graph; is that right?
A. Oh, yeah, you mean the -- the two dotted lines, the dashed line and the solid line?
Q. Yeah.
A. Okay. They correspond to different time

frames, yeah. And the legend is there in the lower left.
Q. Okay. And what -- and what -- the time frames are -- can you explain what they are in this example?
A. This example, it says T+0, which means right now. T+5 is 5 days from now. And that's by the way of calendar day. Option's models are built on calendar days, oddly enough. T+9 is 9 days from now. And T+14 is 14 days.
Q. Okay. The -- the T+0 line that -- the dotted line that goes through the black dot shows -- does that show OptionVue's estimate, the March 3rd value for these positions over a range of futures prices?
A. Well, this case, it's showing a P&L, because, as I said, Catalyst liked the P&L view. But I didn't keep an accurate P&L, so I wouldn't assign any meaning. You know, this -- this says on the right-hand side minus, you know, 55 or 60 percent. So the Fund never had a loss that big, so I can't really interpret exactly what it's looking at. But I do know this thing's set on P&L. So I can't tell you exactly what it's looking at. This is simply Catalyst's files, so...

Q. Okay. Do the numbers below at the bottom of the graph -- well, what -- tell me what are the numbers at -- at the bottom of the graph on the bottom horizontal access.
What do they -- what do they reflect?
A. Well, they were talking about the Greeks. And I -- in my use of OptionVue was to use the value setting, to use the dollar value. So in -- in these terms, I don't know the unit of measure. So it's giving -- if, for example, 1.215 million delta, I don't want to guess what that means, but it's a delta measure.
Similarly, gamma, similarly theta, and similarly Vega. So their -- their option's Greek, but I'm not certain of the unit of measure settings on this particular graph.
Q. Could you control the range of future prices for its OptionVue display, the projected values or P&L in this example?
A. Yes, you can -- in other words, the X axis in this case plus or minus, it looks like roughly 5, 5-and-a-half percent. You can make that pretty much as big or small as you want.
Q. Okay. Then the other three lines, they display projections of P&L over -- over the other

time periods specified, the 5, 9, and 14 days right after March 3rd?
A. Yeah. Again, with the caveat that I had no idea of what the P&L calculation is based on. I can tell that the right-hand side percentage numbers suggests that it's not meaningful in terms of actual P&L, but they're designed to display something at those different time frames.
Q. Okay. And what is the star -- what is the star next to the T+9 line in the -- in the box indicate -- or asterisk?
A. Well, my -- my guess is, because I've not paid attention to that, that's the -- that's the line that's highlighted, which I could tell from the colors, so it -- honestly, I've not known this. Perhaps OptionVue highlights with an asterisk. But it's highlighted is what I pay attention to, so I know what time frame I'm looking at. And whatever these numbers below -- whatever any of the numbers on the page refer to, refers to whatever -- you can click on a time frame you want to specifically look at.
And, like I said, you can tell it's highlighted. That's what I use. I don't recall what the asterisk may mean. This is a -- in this

Page 109

version of OptionVue, this is four years old, so I don't remember what the asterisk means. I just know the highlighted is what I use.
Q. Okay. So when you used OptionVue in the time period we're talking about, again, September or August 2013 through February 2017, you had a graph with four or five lines in front of you like this, you would do -- if you clicked on a particular line or curve, that would -- that would change which information is displayed at the bottom of the screen?
A. Yes.
Q. Okay. So if you are looking at, you know, this example, again, you described that it's displaying P&L information or the active or chosen line, which is the T+9. But in your use of Option, that would -- that would be value numbers, correct?
A. Yes.
Q. Okay. Then what -- so, again, in this example, immediately at the bottom of the graph, the axis, which you see there, there's a range of prices. Then underneath those, there's -- there's percentage points, correct?
A. Yes.
Q. Okay. As you go along out on -- that

Page 110

axis, it's just describing, you know -- it quantifies, you know, what the price is if you go up, you know, .7 percent, 1.3 percent. It's giving you a percentage from the current price, both -- both numerically and in a percentage, correct?
A. Correct.
Q. So then immediately below that, there's -- there's a purple line, colored line, which is one of the reasons, you know, we had this printed in color. And below that, there's a -- there's another colored line underneath it. What is the -- what does the purple line indicate?
A. So the magenta -- I'm a color purist. Magenta, I'm sorry, is -- is the plus or minus one standard deviation line that I talked about before. And the teal below that is plus or minus two standard deviations. And, again, this is one of those parameters where I would have to do in my colloquial, calling it a sniff test, to see whether that -- whether that made sense.
And there's a field without -- if you click on this line, there's a field where you can go in and double check what data OptionVue has collected to display those lines. And, again, I would look at it. And typically if it changed or --

Page 111

or if there was some reason, in my understanding, of market conditions that made it seem unlikely that those lines were correct, I would go in and check what's -- what's the data that OptionVue's collect. But the -- the short answer is those are the lines that tell you a plus -- plus or minus one standard deviation, plus or minus two standard deviation move over the time frame select.
Q. Okay. Going back to the next projected date for a moment. That -- that controls the projection horizon that's displayed, correct?
A. I'm sorry. Which --
Q. The box, the mass -- mass projected date in -- it looks like it's --
A. Yeah. Okay. I see it. Sure. Absolutely. And there's a -- there's a drop-down. You can also manually enter a date. And that's typically the -- it will typically default to -- actually, the -- the nearby options expiration. And it will have drop-downs for every options ex -- expiration that are -- that contain positions.
Q. Okay. So based on the position -- the positions entered in OptionVue, the box where you select one of the different expirations --
A. Yes.

Page 112

Q. -- that apply in the positions or -- or you can manually enter a different date?
A. Yes.
Q. And then I take it the number of lines displayed is controlled by entering a value in the box labeled number line?
Do you see that --
A. Yeah. That one is -- is a simple drop-down of 1 through 5. I don't think -- yeah, it's 1 through 5. So there's not -- you can't put in each. So 1 through 5, you can select.
Q. Was there -- I'm sorry. I think you may have told me there was a default number of lines in OptionVue that would be populated?
A. It typically defaults to five, unless there's less than five days to expiration, in which case you can only have the number of days to expiration, so...
Q. Was it your practice to use the default number of lines?
A. Again, in -- in all the ways I used the tool, I selected based on what it was I was trying to use the tool for. So if I was looking at options with 90 days' expiration, it's likely I would use all five, because that's a long time frame. And a

shorter time frame, I might use three lines. If I'm comparing two positions on the before and after on the portfolio, which can be done, sometimes that gets messy, because now you got five lines where you can compare two or three positions. It gets very messy. You might reduce the number of lines. So once again, I didn't have -- I had -- my practice was specific to what I was trying to use the tool for.

Q. Okay. Well, quickly going through -- I think I'm following you. Quickly going through some of the other information in here, there's -- under the number of lines on the left-hand side of the screen, there's a box for -- it's called -- it's checked, called, Step through date. And then there's an unchecked box, that's, Step through volatilities?

A. Yes.

Q. Can you tell -- can you tell me what those -- what information's indicated there?

A. So step through dates is what we've been talking about, simply means that if you choose four lines or five lines or three lines, it will step through date intervals from today or the current time is to equal zero. In equal increments or at

least as equal as we can make it, as you can see, 14 day -- it goes 5, 9, 14, so it's roughly equal to increments on four lines. But it's stepping through time frames. If you switch the volatility, it will simply display the -- the static curve, and it will step through volatility increments, plus 1, plus 2, plus 3, or whatever increment.

And that's the next one, volatility changing points, which is a misnomer, but it's -- it's labeled points.

So if you set the volatility change to two points and you say step through volatilities and you choose four lines, it will say volatility plus 2, plus 4, plus 6, plus 8. And it will show you what that does to the model values for -- for a single time frame. So it would say T=0, but volatility plus 2 at four lines. In this case, volatility plus 2, plus 4, plus 6, plus 8. And you can do minus --

Q. And -- okay. Thank you.

You said that the points for volatility change was a misnomer. What did you mean?

A. Well, volatility is typically expressed in percentages. So, I mean, you can call it percentage points. It's not -- so volatility goes from 10 to 11. Some people might say that's a 10-percent

increase. The reality is, in this case, it's a one volatility point increase, even though the measure is percentage.

Q. Okay. And for the -- going next to step through dates, so there's -- I thought it would be five lines, as I understand it here. Four lines have been selected. So then would OptionVue just divide the time between the current date and the mass projected date and sort of chop that up by four?

A. That's correct. And, obviously, sometimes it has to approximate. It's not equally divisible by four, but that's the concept, yes.

Q. Okay. In your -- your daily use of OptionVue, would you adjust those -- those sort of default step through dates, or would you use the -- the way that OptionVue sort of divided them up across the five or four lines, or whatever lines you were looking at?

A. Yes. So, again, it all depended on what I was trying to look at. By looking at the entire portfolio, and does the portfolio contain positions out of a long enough time frame? Is it short dated? Because it -- again, if you're looking at a one-week period with five lines, it can get messy. Those

lines don't move much. So you say, Let's go down to three lines. It's a clearer picture of what you're trying to model. If you're looking at a particular position, when's the expiration?

So, again, I'm sorry to be as repetitive as this, but what -- whatever I want to use the tool for would determine how I would set some of those parameters.

Q. Okay. And so if you're going to switch to the step through volatility function. So if the -- if the highlighted line was, you know, T+9 and you click on the step through wall, it would -- it would give you those different -- it would give you volatility for that particular date?

A. Well, it would fix that date in terms of time. It wouldn't give you other time frame. So it fixed that date in time and assumed that that time didn't move. And then it would say -- it would give you step throughs on movement in volatility.

Q. Okay. Under the Volatility Change section where there's a drop-down menu for that, there's another box that says, Amount Provided. And then in that drop down box, it says equal, Orig. It seems to say original requirement. Do you know what inform -- what that means?

A. I -- I don't use that. Again, one of -- OptionVue has some -- some pretty decent accounting features and reporting features that I generally don't use. And so this -- you can go in and say, Hey, I'm opening an account, and I'm going to deposit $100,000. And it will then compute, you know, your P&L based on that as long as you do the accounting, which I -- that's just not what I use the tool for. So that's not a feature of OptionVue I use the amount provided, required, et cetera.

Q. Okay. And you testified that you use OptionVue during -- in a particular time period we're talking about to this point, 2013 through 2017.

But I think I hear you to say that you still use OptionVue --

A. I do.

Q. -- is that correct?

A. Yes.

Q. Okay. You use that in connection with the -- the accounts that you manage currently?

A. Yes.

Q. Do you know what version of OptionVue that is?

A. I don't.

Q. The -- okay. So then there's a box under -- directly under that one, Vertical Axis, with -- you know, the profit and loss. But I take it that's where you could -- you could change the settings to value, and that would change the vertical axis?

A. Correct.

Q. And then underneath that, there's a horizontal access with a sort of button LR, and under that, another button plus, minus.

Do you know what those do?

A. Those allow you to -- to move where the center of the graph is back and forth, and plus or minus makes it bigger or smaller. It actually has a feature you can right click and do it a lot simpler with a mouse. So I can use those as well. But that's what they do. They -- they adjust the scaling on the graph.

Q. Okay. And what about under, Results? There's information -- or there's the words, Target, in one little box, and then, Curr Bell, in another box. Do you know what those represent?

A. I don't -- I don't use that, so -- and I can't speculate that.

Q. And what about the two boxes that are --

that are checked below that, Show BEs, and, Show Obj.Stp?

A. Yeah, again, I don't -- I don't use those.

Q. Okay. So you don't -- you don't use them.

Do you know what they -- they mean?

A. No. Again, I don't -- I don't use them. I don't want to guess.

Q. Okay. We're almost done with this exhibit. If you go to the top, back up to the top of the -- the screen, if you will, you know, there's -- there's several tabs: File, Home, Tools, Data, Settings, Help.

Do you see that?

A. Are we on the same screen? I'm sorry, I started to scroll up and down.

Q. Yeah.

A. Okay. All right.

Q. No, I'm sorry. Same screen.

A. Okay. Which tabs?

Q. So there's -- you see where it says File and then Home, then Tools, Data, Settings, Help?

A. Yes.

Q. All right. So the home tab is currently selected. And then underneath that, there's -- there's, you know, Option. There -- there's Matrix,

Price, Volatility. What -- what are -- what are those in that box that says, Asset Specific?

A. Well, if I had my software open, I could tell you with a lot more certainty. But typically the matrix, I believe, will open into the actual display of options to strike prices and quotes. The price will give you a price grab from the underline.

OptionVue does have some -- you know, it's got -- it's got graphing capability. I want to say they've got some, but not a full fledged charting suite, if you're a technical chartist. The volatility will display a graph of the underlining volatility. So the matrix will give you pricing. The pricing will give you price of the underline graph of the tools.

The volatility will give you a graph of how volatility is behaved all the time. Information will give you -- info gives you set -- a bunch of settings about how you want your account to behave.

And, again, I don't use those. Those are P&L reporting-type stuff. And I just use this for modeling, not reporting. The trade log will have a record of more -- as I suggest, trades.

So when you enter a trade, it will record it in a log form. And, once again, in managing the

Fund, this was a good tool to ensure that we had the right positions in. But it wasn't -- we actually just double-checked with the official accounting record when we periodically checked. We, meaning myself, Catalyst, and my analyst, basically. I don't recall what status means. I don't use that.

Instead, I'll use the reporting. I don't use trade finder or survey. Some of those features -- the OptionVue is built for individual equity options trades. And so there's a lot of features that help -- to my understanding is to help people that trade options that an individual equities -- to scan the universe of option and stocks and look for earnings and look for lots of different things. So some of these have those features, which I don't use.

Q. With respect to trade law when you -- when you mentioned that -- that you were an analyst, someone would -- would check the information against the official accounting record. What are you referring to?

A. So we -- we periodically -- essentially I would ask my analyst, because I would enter the trades personally as I made them. And then I'd ask my analyst a couple of times a week usually to --

basically, I would go get a sandwich and tell him to take over my screen and compare the positions in OptionVue to what the -- the official portfolio record from an accounting showed just to make sure that we weren't missing a position. I mean, normally I could tell by looking at, again, kind of a split test in the graph. But we did go through that line. We wanted to have a second set of eyes instead of me staring at it. I stared at it enough as well to make sure thing's correct. But I would let my analyst just take over and spend an hour doing a comparison just to make sure we had good apps.

And the trade log was helpful, because if there was a discrepancy, we could see was that a double entry in the OptionVue? Was it a -- you know, it was rare. Every once in a while it might have been a mistake in how it was picked up by the accounting -- fund accounting.

So -- so we checked all those things in the trade. The trade launch showed us what was going on in -- in OptionVue. Not -- not the official record, because sometimes if we did find an error, we'd enter a correcting transaction. So you would see something in OptionVue that wasn't an

actual trade, but rather an adjustment entry to bring OptionVue back in line officially. We submitted each day the official trade record, trade log, which was kept. And we submitted that to -- to Catalyst and to fund accounting. So this is just a log of what got entered into OptionVue.

Q. Would OptionVue allow you to -- so using this -- this screen in Exhibit 2 as an example, the -- the four lines displayed the graph and the data corresponding to the active line, would -- did OptionVue allow you to output this information, these values and save them in a computer file?

A. I don't know. I've not done it. I didn't have a -- I didn't ever find a value in doing that, so I'm not certain.

Q. Okay.

A. I mean, as you can see, you can print a screenshot. That's typically -- that's -- that's most of the outputting we did. If we wanted to share a view like this, we do a screen print. But I didn't use it to output any data.

Q. Okay. You never practiced -- have some form of practice of saving or recording the analyses that were from day to day reflected in OptionVue?

A. No. Not -- not the modeling. I mean, we

certainly did studies in which we used OptionVue to, you know, walk through a trading test, and then we recorded results from OptionVue. But we did that, you know, basically manually using OptionVue as the tool. But there wasn't a good way to -- to -- in other words, it's not really a strategy testing tool that you can test a strategy and have OptionVue output tabular results. That was a manual process. We did that, you know, from time to time over certain periods, if we wanted to test the performance of a particular methodology.

Q. Okay. So absent a printout of a screen or -- or some other output of the OptionVue graph or analysis, could -- could you use OptionVue's back trader functionality to -- to go back and determine what -- essentially replicate what -- what an OptionVue analysis would have looked like on a particular day?

A. Yes. That's how we use back trader. You can back to any point in time that they have data for, and there's holes in data. But, you know, ideally you go back to a point in time where data was available. If you want to test a particular position, how it would move through time, or a collection of positions through a particular market

environment and say how would it behave, then, yeah, that's -- that's essentially what back trader's used for.

Q. Okay. And that would be based on the portfolio composition during that prior time period, correct?

A. Well, again, it didn't save prior portfolios. You would have to go back and say, Here's a collection of positions I'd like to test. And so typically, you know, it was -- it was burdensome to go back. So if you wanted to test something, we generally test a generic strategy as opposed to trying to reconstruct pretty complex portfolio from some recent history. It was more around a particular type of position or collection of positions where we entered a simplified version and use that to kind of see how it behaved.

Q. Okay. You could reconstruct the portfolio for a prior time period, but -- correct?

A. You could if you wanted to, you could put anything you want.

Q. Okay. In the box -- for this exhibit, again, the screen we're looking at, the volatility change, you know, it's set to 0.0 percent.

What does that -- what does that mean?

A. That means we're assuming that whatever the current volatility level is doesn't change. And we're just -- we're looking at how essentially price as the only input to changes in the value of the portfolio.

Q. And if this -- if this box contained a nonzero value, then what would OptionVue do?

A. So, for example, if you put a 1 in there, it would adjust all the curves to assume that the implied volatility of the options had increased by one point.

Q. And then OptionVue would compute the option prices using that adjusted volatility estimate?

A. Yes. You'd see each of these curves change position and possibly, likely, in fact, the shape.

Q. Okay. Were there volatility scenarios that you typically considered?

A. Again, in the low volatility environment, typically I would leave that alone. In a high volatility environment, I would stress the downside by increasing even further. And then also look at scenarios in which volatility declined back to more of a norm.

Q. Okay. Did you -- did you stress vol points -- volume points or volume percentage?

A. Well, I -- I used what OptionVue gives me. I -- I know that what OptionVue does is, as I said, if -- if volatility is 10 and I want to stress to 11, I'm putting a 1 in there. So that's a 10-percent increase in volatility, which is a decent size increase. But the way OptionVue models it, it's a lot.

Q. Is there a way to enter the AUM of the Fund in OptionVue?

A. There -- as I said, I know that there's a way to enter account values, but that's not how I use -- use the tool.

Q. In the way that you use OptionVue, would you determine -- even though you had -- as I understand it, the vertical axis set to value, would you determine, on a percentage basis, you know, the impact to that portfolio, given price and volatility assumptions?

A. I'm sorry. I don't think I understand.

Q. Well, would you -- would you determine -- so if you were to set the value and you see that a particular, you know, increase -- you know, for one of the -- the graphs had a particular price, you

know, increase in the S&P 500, for example, by 5 percent, would that have -- you know, result in a particular dollar value impact on the portfolio, would you calculate a percentage by the AUM to determine that on a percentage basis?

A. Yeah. I mean, as I mentioned, about our suite of risk metrics, we had a report that came out every day that -- that measured both on the call side independently, the level of open option. So I had a pretty good -- I had an exact calculation to look at beginning the day. So I knew within the level of precision, I needed to graph where that 8 percent level was in terms of dollars, what dollar level to look at option.

Q. Would you personally -- did you undertake any steps to determine the percentage impact on the portfolio from a projected loss in option -- OptionVue, for example, a hundred million?

A. I don't understand that -- what you're asking.

Q. Well, if you have a value OptionVue's not telling you -- and I think in the way you use OptionVue. OptionVue's not telling you in and of itself that there's, for example, a different scenario that the portfolio would -- would expect

Page 129

to, say, have an 8 percent, you know, drawdown in NAV, how would you -- how would you calculate that from the information in OptionVue?

A. Well, again, I'm trying to say it as consistently as I can. We enter positions at even. So the 8 percent of NAV number is significant, because it's some indication, a pretty close indication, in my experience, that you are experiencing a drawdown in NAV and AUM.

Now, again, every day you have a report showing where we stood against that drawdown number anyway. That was, again, a number Catalyst wanted to add to it. For me at the portfolio manager level, I'm controlling to what I'm seeing in OptionVue in terms of open option premium. And so I'm controlling to that 8 percent line, which alerts me to, all right, here's an 8 percent number.

Now, is that a scenario that is meaningful in terms of the portfolio composition and market environment from the NAV. So -- so, again, within the tolerances of the -- you know, of the -- in other words, for a million-dollar fund, if I'm accurate to a million dollars or $10 million, that's -- that's good enough. That's better than the accuracy of the model, probably significantly.

Page 130

So I know the number that I need to look at on this chart. And then I evaluate whether that's a likely enough scenario to take some action.

Q. On this chart where the volatility, is that referring to the VIX or something else?

A. The -- this is referring -- this volatility is the volatility in the options pricing volatile options using to do its estimate of options or values of different points.

Q. Okay.

A. Each option has its own volatility built into it.

MR. FOSTER: Okay. I'm gonna move on from this onto something else.

Do you want to take a quick lunch break?

THE WITNESS: Sure.

MR. FOSTER: Okay.

MR. KOPECKY: Yeah, up to you guys. So it's 1:00. What do you want? Half hour? Say 1:30?

MR. FOSTER: Yes.

THE WITNESS: That's fine.

MR. KOPECKY: Okay. Great. Back here at 1:30.

MR. FOSTER: All right. Thanks.

VIDEOGRAPHER: We're going off the record

Page 131

at 12:58 p.m.

(Recess taken.)

VIDEOGRAPHER: Okay. We're going back on the record at 1:34 p.m.

BY MR. FOSTER:

Q. Okay, Mr. Walczak, circling back to a topic we talked about earlier in the day, the -- the periodic open house telephone conference calls. You participated in such calls during the period from January 2014 through February 2017; is that correct?

A. I -- I can't swear to the exact window when it began, but certainly they were around for a period of time.

Q. And that period of time spanned several years, correct?

A. Again, I don't know if it was several years, a year, year and a half. They went on for a period of time. What endpoint do you want to use? If you say until the time I left Catalyst, then, yes, several years. If you want to say till 2017, then I'm not sure how long prior.

Q. And during -- during those open house calls, you provided updates -- updates and answered questions from financial advisors, correct?

A. Correct.

Page 132

Q. Those calls were recorded; is that right?

A. Yeah. I found out after the fact that they were. Yeah, they were recorded.

Q. You were unaware at the time that the calls were being recorded?

A. I was unaware of the use of recordings, but they announced at the beginning of the call -- of each call that they would be recorded, but I thought for internal records. It turned out for different purposes, I later discovered.

Q. What -- for what purpose did you think they were being recorded at the time?

A. I thought for simple recordkeeping for some sort of compliance requirement.

Q. And for what purpose did you come to learn later in time that they were being recorded?

A. Well, very much later in time, I learned that they were being distributed as a marketing tool.

Q. Okay. You were -- you were not aware of the fact that -- what do you mean by -- I'm sorry. Let me back up.

They were being used as a marketing tool how?

A. Well, they were being distributed to

Page 133

audiences that have -- unknown to me, but they were being distributed, I later discovered.

Q. You -- you weren't aware at the time that if someone missed the call that there was a recording available that someone could listen to after the fact?

A. No. I was very surprised to understand that -- that the calls were available after the fact to others.

Q. Well, others, they were available after the fact to financial advisors or interested investors in the Fund, right?

A. Again, I have absolutely no idea who Catalyst made those calls available to. My understanding for the time I provided them was that they were being recorded and just kept internally. And I had a phone conversation that -- which I learned otherwise.

Q. What -- based on -- what was the basis for your understanding or belief that the calls were being recorded merely for internal recordkeeping purposes?

A. That's an assumption I made, because no one told me otherwise.

Q. Did you ever ask anybody why they were

Page 134

being recorded?

A. No.

Q. And why did it surprise you to learn that the recordings were made available after the fact to financial advisors?

A. Because I never contemplated that beforehand, so it came as a surprise.

Q. But you understand in real time the information you were communicating was -- was reaching financial advisors, correct?

A. Certainly. I was communicating to people on the call, yes.

Q. What's your understanding of -- of how people received invitations or gained access to -- to listen to those calls?

A. I have absolutely no idea.

Q. Did you ever ask anybody --

A. No.

Q. -- anything about that topic?

A. No.

Q. Are you familiar, generally, with the nature and type of information you provided on the open house call?

A. I'm not sure what you mean by nature and type of information on open house calls. I mean, I

Page 135

was on them.

Q. Okay. What -- what -- what type of information would you share about the Fund during a typical open house call?

A. I would start with a very high level of general overview of how the Fund's positioning -- or positioned. In other words, you know, were we doing cliffs (Phonetically) calls. You know, where did we stand relative to potential, you know, changes in the market, environment changes in volatility, just a -- kind of a general overview of what our strategy -- where our strategy had led us at that point in time. And generally to questions, which I think was the purpose of the call, was to just describe a little bit more about, well, how do you trade these types of calls. So that's the type of information that's typically provided.

Q. During those open house calls from time to time, would you describe how you used OptionVue to assess and manage fund risk?

A. Yeah. There was -- there was a reasonably minor part of the calls in the aggregate. There were a lot of calls. So I didn't -- I certainly didn't get a lot of questions, nothing like what we talked about today, for example, about the detail of

Page 136

the option software. It was more about the strategy.

Q. I'm not sure, then -- I'm not sure I totally understand your answer. From time to time, would you describe how you used a computer program to assess and manage fund risk?

A. Yeah. My sense was that was a small part of the conversations. That's my recollection. But -- but certainly that came up.

Q. And even if you didn't mention OptionVue by name, you described stress testing that you conducted on the portfolios; is that fair?

A. Yeah. Again, when they asked which was a minor part of the -- the information that I was providing. When asked, I -- I responded to the questions about stress testing.

Q. In responding to such questions, did you describe how you used a software program to project portfolio value over several time horizons for range of assumptions about changes in the level of S&P 500 Index future's prices and option volatility?

A. Yeah. I did -- I did offer a -- sort of a generic explanation to give people a feel for the -- the way I used the tool, yes, that's correct.

Q. Did you ever, in sum or substance,

Page 137

represent that an option that was a computer program results showed that one or more of those scenarios involved a loss in excess -- excess of 8 percent of the Fund's NAV that you would hedge the portfolio to eliminate that possibility?

A. Yeah. I did talk about -- because that is the -- the metric that I used. So -- so when asked, again, I don't remember that it was more than a handful of times over the years of doing the calls. But when asked specifically about risk management, I -- I think I very truthfully answered that when I saw a scenario that, in my judgment, would lead to a loss, I took steps to -- to mitigate that potential, at least to the best of my judgment.

Q. Did you ever represent in sum or substance that if OptionVue or a computer program, if you didn't name OptionVue specifically -- let me start over.

Did you ever represent in sum or substance that if the option software you were utilizing showed that one or more scenarios that you were stressing involved a drawdown of more than 8 percent that you would hedge the portfolio to eliminate the possibility of that drawdown?

A. Again, it's -- I have to, again, provide

Page 138

the context. It's kind of rare, so it's difficult for me to remember the specifics. But I do remember having at least a handful of conversations about how I managed risk and how I stressed the portfolio. And, again, it's never -- again, context, never intended to provide a detailed explanation of all the actions I took managing the Fund, but I did talk about being aware -- using an 8 percent number, using a computer model, and mitigating risk when I saw those scenarios appear that I felt were valid ones in which to react to.

Q. Okay. And when you did that, you understood it was important that whatever you said, whether it was at a general or a detailed level that the information you conveyed needed to be accurate, you understood that, right?

A. I understood my audience, and I gave, I think, a truthful account of how I managed the Fund. But, once again, the important context is that these were a group of sophisticated investors. They, in my belief at least, you to -- and were advised beginning of the calls not to take my remarks as a comprehensive description of the risks of the investment, not to take my remarks as a detailed description of all the tools and all the actions I

Page 139

took to manage the funds.

So in that context, I absolutely -- I -- I didn't say anything that I didn't believe not to be accurate and truthful. But I do think the context is important. That's why I've taken some time to make sure it gets on the record.

Q. Okay. What I really want you to do, sir, is to answer my questions and not put in the record what you think is important. So I -- I got your context. I understood what you're saying.

But I'm just asking when you spoke on these calls, did you understand that it was important that whatever you -- information you conveyed needed to be truthful and accurate? You understood that, right?

A. Mr. Foster, all my responses -- and, again, I'm not trying to be difficult here by any means. I simply want to make sure that I'm giving you the whole truth. From my oath, the whole truth. And I can't afford to give you yes-or-no questions that, without context, could be misinterpreted. This is a video deposition. It's going to be replayed. And I must ensure that I'm giving you an accurate contextual response, rather than a simple yes or no. It might be misread -- misleading.

Page 140

Q. Mr. Walczak, can you answer my question yes or no? Did you understand it was important to be truthful and accurate when speaking on the open house calls? Can you answer that yes or no?

A. Of course. Yes.

Q. Okay. Please do. And what's your answer?

A. I'm sorry. I meant that to be my answer. Yes, it was important to be truthful and accurate, yes.

Q. You understood at the time, right?

A. Yes.

Q. Now, there came a point when you told me that you learned that the house calls were -- well, you knew the house calls were recorded, and then later in time you learned what use was being made of those recordings.

Have you ever listened to any of the recordings of the -- of the open house calls in which you spoke?

A. I've had sound bytes played for me, but outside of those sound bytes, I've not -- I've definitely not listened to any of the calls in their entirety.

Q. In what context did you have sound bytes played for you?

A. At depositions like this.
Q. Outside of -- of a setting where you were providing sworn testimony, have you ever listened to any of the recordings of the open house calls?
A. The sworn testimony, including my recent arbitration, the ones I recall very vividly. So if I heard recordings of others, the only other context I could think of would be my attorneys, my counsel playing them for me.
Q. Okay. Well, did that occur? Did you listen to a recording that an attorney played for you?
A. Again, I -- I don't recall that for sure. I recall that I heard sound bytes played for me, depositions and testimony, and, again, arbitration proceeding. And I -- I think my attorneys may have in -- in attorney-client discussions, played sound bytes for me. But in general, I haven't listened to -- I know I haven't listened to an entire -- any of the entire recordings.
Q. Have you ever read a transcript that was prepared of any of the recordings of the open house calls?
A. The same -- same response. I've read sound bytes which, again, drives my desire for

context, because I recognize the sound bytes to be small clips from very, very large conversation, degrees of conversation and volumes of conversation. So the only transcripts I've seen are, once again, sound bytes.
Q. Meaning, you've never sat down with a full transcript of a particular recording and read it from front to back?
A. That's correct. I've not done that.
Q. And you've been shown, I take it, in your -- in deposition or other testimony setting, you've been shown portions of a transcript. Is that what you mean when you refer to sound bytes?
A. I -- I have been shown what I do recognize to be very, very, very small portions of individual calls. And in some of all the calls, I would go to put maybe 100 varies in front of the small.
Q. Well, typically how long would these house calls last?
A. Let's see. So most the house calls included myself and my colleague, Kimberly Rios who managed the Hedged Commodity Futures Fund, so I would typically provide a -- I don't know, maybe a 10, 15-minute overview of the Fund. Sometimes she would then do an overview. And then we take

questions. I think sometimes I might take questions before the overview. I don't recall.
In total, depending on the level of interest, which varied, it could be anywhere between 20 minutes and 45 minutes maybe, maybe some longer. But that's my best guess and recollection.
Q. Sir, have you read the SEC's complaint in this case?
A. I have not -- not recently, but I have.
Q. And the complaint allegations include references to and quotations of certain portions of the open house calls, correct?
A. I believe that's right, yes.
Q. Okay. Have you at any point since the filing of the complaint in late January of 2020 listened to those cited or quoted calls or read transcripts of the same?
A. I don't remember that I matched up, as I said that certainly in that time, particularly with regard in my recent arbitration. And I don't recall specific other occasions, but certainly there have been occasions where I heard, again, the sound bytes, audio sound bytes. Again, I didn't make any effort to match them to the ones quoted in the complaint.

Q. Well, the complaint -- the complaint alleges that you said certain things in the house calls. Did you ever go and check out a transcript or recording to see if what the SEC alleged was -- was true? Did you ever do that?
A. I didn't personally do that.
Q. If someone did it for you, how would you -- how would you -- did someone do it for you, if you say you didn't do it personally?
A. Again, I -- as I sit here today, I don't know that I ever asked my counsel, Hey, did you make sure that this was correct or not correct? It's just not come up.
Q. So the recordings that -- of those open house calls, do you understand those have been provided to you in discovery in this case?
A. I believe they probably have been.
Q. Without listening to the house calls or reading transcripts of the same, are you able to admit or deny what you said during those house calls?
A. I guess if -- I guess I'm relying on the fact that, you know, I don't see anything that sounds like something I didn't say. Like, Oh, my gosh, I don't remember ever saying that. So, again,

in consultation with my attorneys, no one said to me, Ed, did you really say this, or, We listened to the calls and we didn't hear this. So I didn't really see a reason to personally go listen to the house calls.

Q. Well, just to be clear, sir, in these questions and in any question that I may pose to you, I don't want to know anything about what conversations you -- you have or -- or, you know, didn't have with your attorneys or what you may have said to your attorneys or they may have said to you. Just want to let you know that. So I'm just asking really if you personally ever went back, listened to the calls, or read the transcripts to see if what the SEC was alleging about what you said matched with what was in the recording or in the transcript. Did you ever do that yourself?

MR. KOPECKY: Asked and answered three times now.

Go ahead and answer it again.

A. No, I did not personally do that.

BY MR. FOSTER:

Q. Have you sought at any time to determine what you said concerning an 8-percent drawdown limit or threshold in connection with the

Hedged Futures Fund on those house calls?

A. I'm sorry. I didn't understand the first part of your question.

Did I -- could you ask it again?

Q. Sure. Given what you told me about -- about the fact that you haven't gone back and listened to the full call -- the full house calls or read the full transcripts, is it fair to say you've never gone back and looked to determine what you said during the open house calls about an 8-percent drawdown limit or threshold in connection with managing the Hedged Futures Fund?

A. Again, I've been shown the transcripts of -- of, you know, brief sentence fragments and sound bytes recorded from those calls. The words don't immediately concern me in terms of, Oh, my gosh, I probably never said that. So from that context, you know -- again, in conversations in reading the complaint, in conversations with counsel, I've -- I've seen what was said.

Q. Okay. Well, let's -- let's -- I promise I'll show you more than sentence fragments. So let's look at a transcript of one of the open house calls. So if you turn to what's been premarked as Exhibit 3, which is a transcript prepared by a court

reporting service of a house call from November 4th, 2014. And while you're getting that in front of you, sir, I'm going to move it to the marked exhibit folder in Egnyte.

All right. Do you have that exhibit in front of you, Mr. Walczak?

A. I do.

(Exhibit 3 was marked for identification.)

BY MR. FOSTER:

Q. Could you turn to page 15 of the transcript?

A. As numbered on the -- so not the PDF, 15 on the transcript. I've got it, I think.

Q. Yeah, that's correct. Each page of the PDF essentially captures four pages of the transcript. And those page numbers are in sort of small right-hand numbers.

A. Okay.

Q. At the top. All right. So page -- page 15, just to make sure we're on the same page, is page 4 of the PDF.

A. Okay.

Q. Do you see that starting at around line 13 of page 15?

A. Yes.

Q. Okay. All right. You're responding to a question, and you said, Sure. You said, I'll talk about risk management. That's a few lines before. But I want to specifically draw your attention to the sentence that begins, I use risk management, on line 13.

A. Yes.

Q. So particularly the sentence that -- that is going on from there, it reads: I use risk management to control losses to roughly 8 percent. That's the number I use in stress testing. It's larger than the largest drawdown the Fund has had in the last seven years. And that's been a period of time over which the risk management system I use now has been placed. The largest drawdown is a little over 7 percent. As I said, I control it to 8. 8 percent is not a hard number, simply because of slippage and so forth in execution. But that's the number I control to when I do stress the portfolio.

All right. So I want to pause there and focus on the -- on that commentary for a moment.

When you said you control losses roughly 8 percent, does that mean 8 percent reduction in NAV, or an 8-percent drawdown from high water mark, or what do you mean when you said that you control

losses to roughly 8 percent, or you manage -- use risk managements to control losses to roughly 8 percent?

A. Well, again, my goal was -- and -- and I talked about it earlier today in testimony, my goal was controlling that open option value to 8 percent, which for -- in my experience, translated to controlling drop-downs to, as I said, somewhere around 8 percent. Even though 8 percent is not a hard number, there can be slippage and other factors involved. But that was my intention. So that's -- it's exactly what I told you earlier today.

Q. Okay. But we -- an 8-percent reduction in NAV is not the same thing as an 8-percent drawdown from a high water mark, right?

A. Say that again.

Q. What I'm trying to understand is the reference to controlling loss is 8 percent, and using that number in stress testing, I'm trying to understand if that 8 percent is -- it corresponds to stress testing that would show an 8-percent reduction in NAV or an 8-percent drawdown from a high water mark? Which are you referring to?

A. Well, the goal is to try and limit draw downs to -- in the neighborhood of 8 percent, as

I -- as I mentioned here. And the tool I used was to control that open option value. Because in my experience, that allowed me to control draw downs to 8 percent -- or in the neighborhood of 8 percent.

Q. Right. When you say drawdown, I want to make sure I understand what you mean. What do you mean drawdown? Are you talking from a high water mark of the Fund or just a drawdown in -- in the NAV?

A. A drawdown in the NAV. You know, it's -- the -- the 8 percent number apparently was used in a lot of different context, a lot of different marks. My hard and fast rule was to control the option's premium value. My experience was that a monthly time frame -- and I think that's why Catalyst put the explicit 8 percent number in our internal risk metrics -- was simply control of, you know, a relatively short time frame drawdown to 8 percent, so there's -- that's all I can say about that. I guess I'm a little confused by what you're asking.

Q. Sure. We'll -- we'll -- let me -- it might become clearer. But focus for the minute on the references here in this house call is stress testing.

Does that -- does that refer to stressing

the portfolio in OptionVue?

A. Yeah. That's what we talked about today, so, yeah.

Q. When you talk about stress testing or stressing the portfolio in a open house call, you're referring to OptionVue, correct?

A. That's the tool I used, yes.

Q. All right. If we could scroll forward to page 17 of the transcript. And specifically in line 11, starting at line 11.

So you can follow along with me. I'm gonna read some of the -- what's reflected here from page 17 over the next page, page 18.

So starting only page 17, line 11. You state: Second, once I put on positions, and I do -- obviously within a mutual found portfolio I put on positions every day, pretty soon I accumulate relatively complicated options positions or an options portfolio, so that even if you understand options fairly well, if you look at the portfolio listing it for the Fund, it will be difficult for you to understand where do these things come from and what are they designed to do and how will they be affected by the market?

So the good news is I have very

sophisticated options pricing models. I plug the portfolios into these models each day. I stress the portfolio for a series of price movements up to 10 percent. I stress the portfolio for volatility movements. Remember that volatility is the most important component of options pricing. So I have to understand what will happen to the portfolio if one day you see the VIX go from 14 to 25 or 20 to 40 or something like that. So I stress the portfolio for volatility, I stress it for price movement, and then I look over five different time frames. A month from today, two months from today, and several time frames in between. I'll vary those time frames to match up to different times that are important to options, expiration for part of the portfolio, for example.

So I stress the portfolio. I identify what's the impact on the portfolio value at these stress points. And if the impact is greater than my 8 percent limit, then I'll go in and I'll hedge the portfolio to bring it back in line.

Okay. So in this portion of -- the November 2014 -- November 4, 2014, house call, what I just read, again, the sophisticated option was pricing models. That's a reference to OptionVue; is

that right?
A. That's correct.
Q. And this is an explanation of how you -- how you control to 8 percent when stress testing, as referenced earlier in the call; is that -- that fair?
MR. KOPECKY: Objection. Form. Foundation. Mischaracterizes the transcript.
Go ahead, Ed. Try to answer that.
A. So when you say this --
BY MR. FOSTER:
Q. Sure. Well -- here we go.
We just looked at page 15, right? And on page 15 you said you would use risk management to control losses to roughly 8 percent. You say that's the number you use on stress testing.
Okay. Now on page 17, over to page 18, you're describing that stress testing, correct, and how you use it to control to an 8 percent number?
MR. KOPECKY: Objection. Form. Foundation mischaracterizes the transcript itself even. Go ahead, Ed.
MR. FOSTER: That -- that's a question. He can answer it -- he can answer it yes or no. If that's not what he's doing, he can tell me what he's

doing.
MR. KOPECKY: It's an objection of a question. You're combining parts of the large transcript. You've taken the world control losses on one page. He's giving -- the thing you read is the second of one, two, three, that he was explaining. Right there he says stressing for volatility. You're combining things that should not be combined. That's what you're doing. And that's objectionable. He can answer the question and will, obviously, but your question is objectionable.
MR. FOSTER: I got your objection. It's oceans away. And I have your --
MR. KOPECKY: Good.
MR. FOSTER: It's not even remotely -- it's not even remotely what I'm doing. Not even remotely.
MR. KOPECKY: Mike, you tried to argue with me about --
BY MR. FOSTER:
Q. Mr. -- Mr. Walczak -- Mr. Walczak, page 17, line 11 to page 18, 14 -- line 14 that I just read, okay? Is that what you did? Is this -- this information accurate, what you said in this portion of the house call? Is that what you did in

the portfolio?
A. I think that's -- that's exactly how I described it to you before. In particular we can look at -- up there in the time frames to match up the different time frames, important options expiration, what part of the portfolio. I stress the portfolio if I see something that's greater than 8 percent limit. I'll go ahead and hedge the portfolio to bring it back in line.
I think that's how I described my process, so I don't have a big objection with that. But I also will agree that, you know, you want to take this in context and with -- and probably in context with all the other times in 2014 that I discussed risk management on these calls, which you probably did, too.
Q. So when you say hedge the portfolio here -- hedge the portfolio to bring it back in line, what does -- what does that mean?
What do you mean by hedge the portfolio?
A. That means if I see a likely scenario, as I described earlier today, if I see a scenario that I believe to be likely enough to take action, that shows an 8-percent drop down, I'll go in and do any number of hedging procedures, including taking

positions off, exiting positions, buying additional options as a hedge, buying and selling options to reduce the exposure by one expiration selling another. So a lot of different hedging techniques that I'll use to satisfy myself that I've taken a likely 8-percent loss and made it less likely or unlikely.
Q. So -- so hedge the portfolio would mean to execute trades, right?
A. Not necessarily.
Q. Okay. How would you hedge the portfolio without -- without executing any trades?
A. Well, if -- if options are wasting assets. So the risk of an option detains as time passes, generally speaking, all else equal. So in some scenarios, particularly short dated options, you look, you identify a potential risk point, and you know that that risk is deteriorating rapidly over time and no action's necessary.
Q. So here you're describing stressing the portfolio at -- at given points, and you describe price movements and volatility movements, right?
A. Correct.
Q. And you say that you identify the impact on the portfolio value at the stress points.

That's -- that's what you would do in stressing the portfolio as described?
A. Yeah, which line are you referring to? I don't remember the specific statement.
Q. Sure. On page 18, that's towards the end of what I quoted. Right --
A. That's what I mean, the open option value, sure.
Q. So when you reference, My 8 percent limit, what are -- what are you referencing?
A. Well, I think I -- I talked about that earlier in this -- in this call. And that was to say, Look, it's -- it's not a hard number. There's lots of other factors. But that's, you know, a guideline I use. That's a number I'm looking for in terms of open option premium. And if I see a scenario where I'm uncomfortable with how likely it is that that happens, then I'll go in, and I'll take whatever action necessary. Or I'll identify that the scenario is unlikely and I won't do anything. Or I'll identify the fact that doing nothing is also a lot of risk to come off, because of the nature of the options.
Q. Okay. Well, I understand that's what you told me earlier. But I'm asking you very more

specifically about what you said on this house call, and -- and the page we're looking at, you said impact was greater than 8 percent limit. And so right now I'm just asking you what 8 percent limit are you referring to? 8 percent of what?
A. What I always look at for -- for that number is described in OptionVue. If the open option value is greater than 8 percent of the portfolio.
Q. And if it is, you say here that, I'll go in and I'll hedge the portfolio to bring it back in line. That's what you said here, right?
A. Yeah. And -- and, again, not to be misleading in --
Q. I'm -- I'm asking you -- I'm just asking you that's what's reflected in the transcript, correct?
A. Well, again, reflected in the transcript, I -- I mean, this is --
MR. KOPECKY: No. It misstates what is said in there. It identifies the impact and the portfolio these various stress points, then if it's greater than a percent, he goes in and hedges to bring it back in line. You're picking and choosing -- you're unfairly picking and choosing

sound bytes. I object to it. It's objectionable. Form. Foundation. Mischaracterization. Mischaracterizes the transcript.
Go ahead, Ed, and do your best.
A. So, again, you know, I don't object to the accuracy of this transcript, but I think it's important that you understand, and especially anybody who might view this record, that the intent here is we have a sophisticated audience. I'm describing what I do not in complete form, that's what perspectives is for, but I'm trying to give them a flavor for what I do and what I said at this time was certainly accurate. But implicit in all of my remarks are use of my professional judgment about what -- what needs to be done and when it needs to be done. These are certainly the techniques that I use, as I described to you earlier today.
BY MR. FOSTER:
Q. Okay. But what you say here, sir, is that if the impact of this the stress testing described is greater than your 8 percent limit, you'll go in and hedge the portfolio to bring it back in line. That's what you state here in this house call, correct?
MR. KOPECKY: Objection. Form.

Foundation. Mischaracterizes the entire house call.
Go ahead, Ed, try again -- oh, and asked and answered three times now.
MR. FOSTER: None of those are valid objections. You may -- you can answer.
MR. KOPECKY: Your question's --
A. I'm not writing an offering document, and I'm not describing either verbally or in this transcript, a comprehensive, detailed --
BY MR. FOSTER:
Q. Sir, that's not my question. That's not my question. My question, Are --
A. Yeah, I understand.
Q. Are the words -- the words that appear on the page, did I read them correctly? Are those the words that appear on the page of the transcript?
A. Mr. Foster, I -- I apologize. We -- I think we agreed not to talk over one another at the beginning of the testimony, so if you allow me to answer your question as completely and truthfully as I can, that's all I ask.
Q. Well, sir, unfortunately, I don't have all day. And you're taking up more than -- than the time that's -- that's appropriate to answer these questions. I've listened to all your

Page 161

contextualizations at this point. And at this point, I really just want you to listen very closely to the question I'm asking and answer that question and that question only.
A. I'm doing the best I can, but I -- I can't --
MR. KOPECKY: Ed, I'm sorry, let's reset.
Go ahead, Mike, ask a question.
BY MR. FOSTER:
Q. So, Mr. Walczak, you say in this transcript that if the stress testing that you identify and explain here over pages 17 and 18, if that stress testing reveals an impact on the portfolio greater than your 8 percent limit, that you'll go in and you'll hedge the portfolio to bring it back in line. That -- that's what you said here, correct?
MR. KOPECKY: Objection. That mischaracterizes what that says, so form, foundation, and mischaracterizes that transcript.
But go ahead, Ed. Is that what you say there?
A. That's what I said, and I'll -- I have to complete -- I have to continue to provide the context in which I said that.

Page 162

BY MR. FOSTER:
Q. And you don't say -- you don't say that you may go in and hedge the portfolio depending on your assessment of the likelihood or probability of that scenario materializes, right? You don't say that. That's not what you say here, is it?
MR. KOPECKY: Objection. Again, in the -- through this whole transcript and in with the beginning of it referring to the prospectus, and as he says about the stress points, yes, he does. So you're mischaracterizing the transcript. I object.
Go ahead, Ed.
MR. FOSTER: Just state your objections. I'm not asking you the questions, Jim, so you're -- it's not your turn to testify about what it does or doesn't do.
MR. KOPECKY: You -- you continue -- you --
MR. FOSTER: No, I don't. No, I don't.
MR. KOPECKY: You continue to misrepresent what this says and that's --
MR. FOSTER: No. No.
BY MR. FOSTER:
Q. It's a very simple question, Mr. Walczak.
Do you say that? Show me where in this

Page 163

exhibit you say that you may, if your stress testing reveals a impact on the portfolio that's in excess of your percent limit, that depending on your assessment of the likelihood or probability of the scenario that you stressed, then you may go in and hedge.
Where do you see that in this transcript?
A. So --
MR. KOPECKY: Well, you haven't read the whole transcript, have you, Ed? Do you want him to pause and read all the pages?
MR. FOSTER: I think he's had ample opportunity to read this transcript at this point.
MR. KOPECKY: He has not. You just asked him if it said anywhere in this transcript. I'm going to have him go back, and we're gonna read this entire transcript.
Do you want to do that?
MR. FOSTER: Yeah, I wanted you to do that when I -- when I served you interrogatories on this very subject, that's what I wanted you to do.
MR. KOPECKY: Well, you got answers to those interrogatories. If you want him to spend the time here right now reading the whole transcript, we'll do it.

Page 164

MR. FOSTER: Well, my -- I want him -- I want him to answer the question. If you later, outside of this deposition, can confine that for me where you say that in here, I'm all ears. But I'm asking you about this particular portion that we just read through on pages 17 and 18.
MR. KOPECKY: Again --
MR. FOSTER: That's my question.
MR. KOPECKY: That's a different question, and I object to that.
MR. FOSTER: That's the question -- that's the question I'm asking. That's the question I'm asking, so please answer that question.
MR. KOPECKY: Okay. So want to repeat that question again?
MR. FOSTER: All my questions right now are focused on page 17 and page 18.
MR. KOPECKY: Okay. So, for the record, then, you're agreeing that you're ignoring everything else that's said in this transcript.
MR. FOSTER: Nope. No. Nope. That's -- that's not at all what I'm saying. I'm just asking a question about these particular pages. I don't need to ask about the entire transcript. That's not my question. So my question is about these -- this

content, so --
MR. KOPECKY: Just to make sure we're understanding.
MR. FOSTER: Mr. Walczak, please -- no --
THE REPORTER: I'm sorry. If you want a clear record, I advise you to speak one at a time.
MR. FOSTER: Stop interrupting.
MR. KOPECKY: I need to understand the question before I can let him answer.
So do you want to try asking --
MR. FOSTER: How do you not understand the question? How do you not understand the question? What's there not to understand?
MR. KOPECKY: Because the question -- you're saying you're not ignoring all of them, but then you're saying, I'm only focusing on 17, 18, and 19.
MR. FOSTER: Jim, I don't have -- I don't have time to debate. You -- you -- you are putting in argumentative and speaking objections. Just state your objection. It's noted for the record, and then I want the witness to answer my question.
MR. KOPECKY: Ask your question. I'll state my objection.
MR. FOSTER: I've already asked my

question five times. I'll ask it again.
MR. KOPECKY: Okay. Can you read the question back?
MR. FOSTER: Well, I'm not gonna -- I will read it again so the court reporter doesn't have to dig back past all your commentary.
THE REPORTER: Please hold.
Question: So, Mr. Walczak, you say in this transcript that if the stress testing that you identify and explain here over pages 17 and 18, if that stress testing reveals an impact on the portfolio greater than your 8 percent limit, that you'll go in and you'll hedge the portfolio to bring it back in line.
That -- that's what you said here, correct.
MR. KOPECKY: Objection. Form. Foundation. Mischaracterizes the transcript. Assumes facts not in evidence, and argumentative.
Ed.
A. Again, no, sir. My words and truthful and accurate in the context of the fact that I spoke in an informal question-and-answer session. I was not writing a prospectus. I was not attempting to provide a comprehensive and detailed description of

everything I did mention in the portfolio, and implicit in my remarks were -- are the metrics that I used. But the transcript words are correct in terms of the what I said, as far as I remember.
BY MR. FOSTER:
Q. And anywhere on page 17 or 18 of this transcript, do you say or explain that you're going to use discretion or judgment about the likelihood or probability of a scenario before deciding whether you go in and hedge the portfolio?
Do you explain that here?
MR. KOPECKY: Objection. Form.
A. I believe those disclosures are contained in the prospectus, but, again, I'm not an expert. But the assumption -- my assumption in making these statements was that I did not need to pile on this disclosure about judgment and opportunities.
BY MR. FOSTER:
Q. Again, I'm not -- I'm not asking about the -- about the prospectus. I'm asking about the words you said on this particular house call. And you would agree with me, sir, you don't say or explain that if the impact is greater than your 8 percent limit that you'll exercise discretion and decide whether or not to hedge the portfolio.

Rather, you say that if it exceeds your 8 percent limit, that you will go in and hedge the portfolio to bring it back in line, right, that's what you said?
MR. KOPECKY: Objection. Form. Foundation. Mischaracterizes his testimony. Asked and answered. Argumentative.
Go ahead, Ed.
A. Again, I described my process, and I think this is a truthful and accurate reflection of my process. My intent here was to provide a flavor for how I managed the Fund, recognizing that in everything I did, I used my judgment, which I described to you earlier. Even in using these words, I was referring to scenarios past that judgment screen so that if I -- if I saw a scenario that was 8 percent and it was in my judgment likely, then I wouldn't go in and hedge it. And I didn't believe at the time, given the audience and the context of this call and others, that it was necessary to say that explicitly. I wasn't writing a prospectus.
BY MR. FOSTER:
Q. But, again, I'm not asking you about -- I'm not asking about what was in your mind or what

Page 169

you thought or why you did what you did. I'm asking you about the words you spoke. And you say here that you -- the words are, I'll go in and I'll hedge the portfolio to bring it back in line, not I'll -- I may go in and hedge the portfolio to bring it back in line, right?
MR. KOPECKY: Same objection.
A. The words are --
BY MR. FOSTER:
Q. I'll -- I'll --
A. I can't help you with the words. And so I'm not going to tell you they're my words. But I think the context is important. Otherwise, I can't provide you misleading testimony, and that's the only reason why I continue to try and provide this -- this context, because the words are --
Q. Mr. --
A. But the context is --
Q. Mr. Walczak, I'll -- the word, I apostrophe L, that's an abbreviation for I will, correct?
A. Yes, it is.
Q. Okay. So it's not an abbreviation for I might or I may, right?
A. As far as I know, it's not.

Page 170

Q. The stress testing that you describe over pages 17 and 18 of the transcript of this house call, how often did you do that?
A. I did that on a daily basis.
Q. And you did that -- you did that on a daily basis over -- over what time period?
A. I think I described my process to you earlier today, so, again, I'm sorry to take up your time, but -- but to repeat it to get your question answered, each day I opened up OptionVue. Depending on what was going on in the market and the portfolio, some days I spent a lot of time on stress testing, sometimes it was a pretty quick exercise to understand that nothing had changed requiring my action. In all cases, I looked at a market and portfolio appropriate excursion of price and volatility and made a judgment on whether there was a likely scenario that required immediate action.
Q. Did the stress testing that you described here in the -- in the house call, did you perform that stress testing all the way over this -- the time period of September 2013 to February 2017?
A. To the best of my recollection, as I said, every day I came to work and upgraded the Fund. I opened OptionVue and went through that process.

Page 171

Q. Sir, if you could turn your attention to what's been premarked as Exhibit 4.
A. Okay. Got it.
(Exhibit 4 was marked for identification.)
BY MR. FOSTER:
Q. All right. And Exhibit 4 is a transcript of a open house call from October 13, 2015. And if you could turn your attention, starting at page 14, lines --
A. Okay.
Q. Line 23. So reading on from where, you state that: In other words, we'll take a snapshot of our portfolio within our options modeling software and then we stress that portfolio against price, volatility, and across time, because obviously time is an important element to waste an asset like an option. So we're on a daily basis, we'll -- the portfolio in aggregate is plugged into our options modeling software, and we'll stress price moves of plus 5 and plus 10 percent on the S&P, and minus 5, minus 10, and minus 15 percent on the S&P.
We'll then -- we'll have snapshots of the portfolio value at those P&L, basically at those stress points. We will then stress volatility in

Page 172

the current environment where we got a sub 20 VIX. We stress the volatility to a 30 and to a 45. In those environments where VIX is already above 30, we'll stress an additional level up to 60.
So now we have price and volatility stresses on the portfolio. We look at that across five different time frames and what we're looking for is a drawdown of greater than 8 percent in the portfolio value. If we find that at any one of those price and volatility stress points, we'll identify whether it, for example, it's price or volatility, which are the two major impacts. On the portfolio we'll identify what is it that's causing that potential 8 percent drawdown or greater than 8, I'm sorry, that's our line in the sand, so to speak.
We'll identify what is it. Is it price? Is it volatility? We'll then identify what hedging transactions we need to put in place, and normally there's a variety of choices. Via put, via put spread, via call, via call spread, buy back a short call, buy back a short put. Lots and lots of alternatives, but we'll model the most effective alternative to remove that risk excursion and then we'll implement that position on the portfolio. So that's what we do internally to manage the

Page 173

portfolio.
All right. So I want to ask you some questions about that language in the house call transcript. Again, is the options modeling software being referenced, that's OptionVue?
A. Yes.
Q. In what I just read, at one point you said, We looked across -- looking at it across five different time frames, what we're looking for is a drawdown of greater than 8 percent in the portfolio value.
So, again, what are you referring to when you say, Drawdown of greater than 8 percent in the portfolio value?
A. Again, I always use the open option premium. That's what I look at in OptionVue. Drawdown value, negative option premium. To me, the language is critical. At least how I looked at it.
Q. So measured from when or from what, a drawdown from what, the prior date's close? High water mark? What?
A. Again, I didn't have -- that was the nature of these calls. I wasn't trying to provide a precise set of metrics or language. I was trying to say how I managed the portfolio, and that -- and how

Page 174

I managed the portfolio as, again, I described is when I saw 8 percent open option premium knowing that I entered spreads per cost, that meant there was risk in the portfolio that I needed to -- to manage again, as long as there was a scenario that had some level of likelihood. And that's my judgment.
Q. Yeah, I'm really just focused on those words, The drawdown of greater than 8 percent in the portfolio value. It had -- that 8 percent had to be measured from something. So I'm asking measured from what? What were you measuring it from?
A. Well, I -- I've -- again, I apologize for repeating it. Maybe I'm not being -- sorry if I'm not expressing myself. That's negative 8 percent option. That's what I meant when I said it. I don't know if later in the transcript somebody asked me, What do you mean by that? I don't know. I haven't read the whole transcript. But that's what I meant when I said it, because that's how I always managed the Fund to the 8 percent open option value.
Q. So when you -- when you said you're looking for a drawdown of greater than 8 percent portfolio value, you meant -- you meant what exactly? You meant in excess of 8 percent of open

Page 175

option premium?
A. Correct.
Q. And how -- how did you know -- from what point -- from what date to what date?
A. I didn't measure from date to date. I looked at -- you know, as I described, we looked at scenarios. We said where in price, time, and volatility is -- is there an 8 percent drawdown? Lots of places. Are any of them likely enough to take action? Yes, no. And take action if necessary. So I was simply -- and that is the reason why I use that measure. I didn't have to get tangled up in from when to where to how. But rather, if I -- my experience from a process standpoint. If I -- if I hold and react to a likely 8 percent open option premium number, that's good risk control. It limits my drawdown.
Q. Is an 8 percent open option premium valued the same as -- as an 8 percent drawdown in portfolio value? Are those the same things?
A. I would say no.
Q. What's the difference between the two?
A. Whatever -- again, I didn't do fund accounting. So my experience was that if I control to the open option premium, it's -- it's effective

Page 176

in controlling my drawdown.
Q. So if you're at 8 percent of open option premium, then -- then what -- what is the total open option premium? Where -- where is that number? From which to take the 8 percent?
A. Well, that -- the open option premium value is what I measure using OptionVue, all the prior testimony that we went through about how OptionVue works and the values I look at.
Q. Okay. Well, where in OptionVue do you find the total open option premium?
A. That's what OptionVue tells. We talked pretty extensively about this. You asked me about screens. You asked me about curves and time frames and volatility. That's what OptionVue is modeling. How I use it, it's modeling the open option value contained in the portfolio or whatever positions I put them in. So that's why I'm looking for the 8 percent number.
Q. Okay. So is that different than say -- would that number be different -- that number be depicted on the horizontal or vertical axis?
A. On the vertical axis, yes.
Q. Okay.
A. It wouldn't calculate the percentage. It

would -- it would be depicted in dollar terms.
Q. Okay. On the -- on the left vertical or right vertical axis?
A. Top of my head without looking at the screen, I can't tell. I can't remember.
Q. So how do you get to a percentage from that open option premium value?
A. Dollars divided by AUM.
Q. So net dollar value of whatever positions you're modeling divided by AUM?
A. Correct.
Q. When you say that the 8 percent is -- you say that you'll -- on the portfolio will -- will identify what is it that's causing the potential 8 percent drawdown or greater than 8, I'm sorry, that's our line in the sand so to speak, what did you mean when you said, Line in the sand?
A. I meant that the 8 percent was the -- the line that I looked for -- in other words, so I had an objective level that I could look for if I found a scenario -- a likely scenario that's causing the drawdown, that's the level I used. So 7 percent, okay. 9 percent, not okay.
Q. In your prior answer when you said dollars, you referenced dollars divided by AUM. AUM

as of what date?
A. The current AUM in the Fund. Whatever I was -- whatever day I was doing stress tests.
Q. Okay. If there was a 2-percent loss a week prior, does the 8 percent reset?
A. Not in terms of open option value, no.
Q. All right. So here you're stating you identified any of the stress points. You identify price, volatility scenarios, and depicted loss of more than 8 percent. You modeled potential trades and implement a trade or series of trade so that OptionVue would no longer show loss or show that -- that scenario in excess of 8 percent; is that right?
A. Which -- which lines are you referring to?
Q. Well, again, you're talking -- if you look here, you're talking about the five different time frames. We looked at that across five different time frames. We're looking for a drawdown of greater than 8 percent in a portfolio value. If we find that at any one of the those price volatility stress points, we'll identify whether it, for example, it's price and volatility, which are the two major impacts. And then you say, On a portfolio we'll identify what -- what is it that's causing that potential 8 percent or greater than 8, I'm

sorry, line in our sand, so to speak. And identify what is -- what is it in the price of volatility that will identify what hedging transaction would put in place. And then you go on to say that, We'll model the most effective alternative to remove that risk of excursion, and then we'll implement that position on the portfolio, right?
A. Again, if you can -- I wasn't following along. So if you want me to confirm the words, just give me lines. I'll read them to double check. It looks like page 15. To be conscious of your time, I'm finding those words on page 15. And so I'm agreeing that those are the correct words.
Again, find a scenario, there's a likelihood and judgment test always. And so that's accurate. That's exactly what I would do in this particular environment, probably those levels were appropriate. I don't recall the portfolio composition or the market environment at this particular moment of this house call, but that's -- that's my process. That's consistent with what I testified.
Q. Okay. Again, so on that page -- on 15 over 16, you say, We'll model the most effective alternative to remove that risk excursion. I'm now

on page 16, starting at line 5: We'll model the most effective alternative to remove that risk excursion, and then we'll implement that position on the portfolio.
Do you see that?
A. Yes.
Q. Again, will -- will implement that portfolio, W -- that position on the portfolio. W-e, apostrophe, l-l, is an abbreviation for we will, correct?
A. Yes.
Q. It's not an abbreviation for we may or we might, right?
A. No. But, again, to -- to remind you the context of the words, it's not unusual to find a scenario and decide it's either unlikely and there's no action required. It's also not unusual to find a scenario to notice that the next T+7 timeline removes the risk stress, and to make the judgment that taking no action, wasting nature time decay and options would solve the problem. So that's also -- that's one of the risks mitigation opportunities. It was certainly my intent when I gave this description that that was implied.
Q. The information that we read from page 14

Page 181

over to page 16 of this open hall -- open house call transcript, do you believe these are accurate statements?

A. Well, on page 14, there's an odd looking -- must have been a typo, so I'm not sure what it meant, it's got more mature prophecies in place. That's what that means.

So what was your question again? I'm sorry.

Q. Are the statements that you made between pages 14 and 16 of this house call transcript accurate?

A. Again, I have to remind you the context in my meeting, but I -- as I described, this is a -- this is a very accurate, generic, and truthful description of my process.

Q. Okay. You refer to it as generic, and I think you used that language about the prior house calls. Was -- was there a form in which you provided more, you know, specific and less generic information to interested financial advisors or investors about your stress testing process?

A. Yeah. I mean, across all these house calls, including the one out of -- I don't know how many that you selected here. All of them had the

Page 182

opportunity for follow-up question if there was some question or need for more specifics by the audience.

And, again, I mentioned that I understand they were distributed or available. So even with -- if someone had a question, What did you mean by that, I was certainly open to it, but I don't recall receiving any.

Q. Yeah, I'm not asking about whether you received questions about -- about what you said on house calls. You're describing these -- the words you used as generic descriptions of the stress testing process. I'm asking if -- if in any form, whether it be on a house call or otherwise, you provided a more detailed, what you would consider to be less generic description of how you stressed the portfolio in OptionVue?

A. I don't recall. As I said, the descriptions of this were fairly few and far between. So there were a lot of house calls, a lot of advisor calls. So did my description move according to what I was doing at the time and the portfolio marketing conditions, it may have, but I don't remember for sure what words I used. Again, not providing a prospectus or providing a detailed description of all the activities involved in

Page 183

managing the portfolio.

Q. How would someone listening to the house call know whether your description was generic or not? How would they know that?

A. I think they would probably ask if they wondered. That would be my expectation, at least from a group of reasonably sophisticated investors.

Q. How did you know the -- the audience of the open house calls were sophisticated investors?

A. Catalyst told me that they were.

Q. Who did?

A. Catalyst.

Q. Catalyst. Who at Catalyst told you that?

A. Well, when Catalyst asked me to do the calls, they said they were only financial advisors they had on this call. And they were qualified, sophisticated investors.

Q. And who at Catalyst asked you to participate in the open house calls?

A. Jerry Szilagyi, you know. In principal meeting, he said, Ed, I need you to do these. And specific scheduling was done by a whole variety of people in marketing.

Q. When you -- when using -- AUM stands for assets under management, right?

Page 184

A. I'm sorry. I didn't -- I didn't hear that word.

Q. Sure. I apologize. The acronym AUM.

A. Yes.

Q. That means assets under management, correct?

A. Yes.

Q. So when using AUM to determine the 8-percent drawdown limit, did you ever measure that 8 percent from the Fund's historic high water mark?

A. First of all, I don't know that there's really an 8-percent drawdown limit. As I said, I managed to an 8 percent open option premium number.

Catalyst, including their risk, controls an 8-percent 30-day rolling trigger to ensure that if the 8 percent open option premium or something else wasn't working, my judgment, for example, if that was incorrect and we saw an 8-percent rolling drawdown, that would get an all-hands-on-deck situation to figure out if there was a problem, what to do. But there wasn't a limit at all. That's -- yeah, that's not a good word.

Q. What's not a good word? Limit?

A. Correct.

Q. My question's a little different.

When you're using AUM to calculate 8 percent open option value that you measured from the Fund's historic high water mark. That's my question.

A. No. My measurement was current AUM, current open option premium, or projected open option premium. But current AUM was the number I used.

Q. All right. And so when I was referencing 8-percent drawdown limit, you told me that's not a good phrase.

A. We've got some audio feedback happening. Okay.

MR. BYLINA: I'm sorry, guys. That was me. I had to shut the -- Steve Bylina. I had to shut off my computer and go to my phone. So I apologize for that. But that's the phone I have. That's me.

THE WITNESS: All right. So, I'm sorry, your question was, again?

BY MR. FOSTER:

Q. You corrected me in response to one of my questions when I referenced an 8-percent drawdown limit. You said limit was not a good word, not a correct phrasing. Is that what you told me?

A. Correct.

Q. Okay. But isn't that the word you used -- you didn't use the word limit in just the prior house call we looked at -- or one of the ones, November 4, 2014 house call?

A. I don't remember. If so -- again, context, and the reason I objected to the word is there's, as I said, on a number -- I think I said on a number of those calls, there were no guarantees. Even on that -- this transcript or the other one, there was definitely my saying that there was no guarantee, because it's important. It's a goal.

Q. Right. So to that point, I mean, in -- when you're seeing in these house calls statements by you that you modeled 8 percent, right, but that doesn't mean -- that doesn't mean in the real world, in the actual market conditions, that draw won't exceed 8 percent, correct?

A. That's correct.

Q. Okay. But what you're conveying is that you're taking proactive steps in an attempt to avoid such a drawdown by modeling to an 8 percent threshold, correct?

A. By modeling the old option preview, but that's correct.

MR. FOSTER: Okay. I'm gonna mark through a couple more of these. Let me take a five-minute break.

VIDEOGRAPHER: Going off the record at 2:59 p.m.

(Recess taken.)

VIDEOGRAPHER: We're going back on the record at 3:14 p.m.

BY MR. FOSTER:

Q. Sir, if you could take a look at what's been premarked Exhibit 5. And that's the transcript of March 1st, 2016, open house call.

A. All right. I have it here.

(Exhibit 5 was marked for identification.)

BY MR. FOSTER:

Q. All right. If I could direct your attention to the discussion on page 27 over to page 28. In particular, starting at line 5 on page 27. Let me know when you've had a chance to read that.

A. Just page 27?

Q. I'm sorry, 27 to 28.

A. Okay. Okay.

Q. So this is the house call. Again, you're discussing how the stress -- the portfolio for

changes in price moves and volatility movements?

A. I see that, yes.

Q. And after describing that process, and you give examples of, you know -- if markets of 5 percent or 10 percent and stress points related to volatility declines or increases in saying, We have a collection of stress points. And after that, you say, And what we are looking for at each of those stress points is an 8-percent drawdown in the value of the Fund.

So, again, there you -- you're referring to -- when you say 8-percent drawdown in the value of the Fund, what are you referring to?

A. Yeah, as I've mentioned before, I thought numbers were a pretty good correlation with the value of the Fund and value of the open option. So that's what I opened in OptionVue.

Q. So just so when we get an 8-percent drawdown and the value, you're looking for those stress points, an 8-percent drawdown in the value of the Fund -- okay. And you described -- I think you described what that means. That's not a reference to a drawdown from the high water mark?

A. That's not what I meant when I said this, because I -- like I said, I looked at open option

premium, so...
Q. Do you know what the Fund's high water mark was?
A. No.
Q. Do you know when it achieved its high water mark?
A. No.
Q. Was that -- was that a data point that you were familiar with on a day-to-day basis in managing the Fund?
A. No, I didn't look at it on a day-to-day basis.
Q. Did you look at -- look at it at all for any purpose?
A. I don't recall. It wasn't something I paid a lot of attention to.
Q. And why was that?
A. I'm not sure how to answer that. There were a lot of things I paid close attention to.
Q. Did you ever tell people that you were monitoring the funds from a perspective of where it's good with respect to its high water mark?
A. I don't -- I don't remember if I talked a lot about high water mark. I used to pay attention to high water mark in the Fund's predecessor. But I

don't remember if I talked much about high water marks in a mutual fund context.
Q. Whether you talked -- whether you recall talking about it or not, if I understand your testimony, you're telling me it was not a data point that was important to you in managing the Fund?
A. Not on a day-to-day basis, no.
Q. Well, if not on a day-to-day basis, over any other time period, was an important data point for you in managing the Fund?
A. I would say that, you know, when I went to a period where we had some downside volatility, we start to look at the, you know -- the depths of where we were from a recent high period of time.
Q. If you turn over to -- jump over to page 29 around line 19, the transcript states that: We stress the portfolio across a number of different dimensions. We look for where, what conditions might cause a greater than 8 percent drawdown.
If I understand that when you use those words, 8-percent drawdown, you're, again, referring to this open option premium that we've discussed?
A. Well, in this case, it's more talking about -- as you can see in the context, it's more talking about investor kind of fund at a bad time

and find his personal investment down 8 percent, or fund down 8 percent from whenever it came in. So, yeah, this refers to some kind of high water mark. I mean, I was trying to explain the genesis of how I set the risk parameters, which is back in the predecessor fund days where we monitor draw downs on a monthly basis.
But my response to you is that it's not something that changes every morning and looked and said, Where are we in a relation to our high water mark? When was our last high water mark? Unless we got into a period of difficulty where that became important.
Q. Right. So on page 29, reading on, you know, 19, you say: We stress the portfolio across number of different dimensions. We look for where, what conditions might cause a greater than 8 percent drawdown. We then model hedging techniques, meaning the purchase and sale of additional options contracts, either ones we already hold -- taking positions off is one thing we model, adding additional positions as hedges is another thing that we model and that's our most common adjustment. We'll model adjustments. We'll choose the most economical and effective adjustment to bring us back

in bounds so that we can no -- so that we can no longer find a stress point that will result in greater than an 8 percent drawdown.
That's what those lines in the transcript say, right?
A. Yes.
Q. All right. So it's actually stated pretty clearly in here that if you find a stress point that will result in a greater-than-8-percent drawdown, you will buy and/or sell options so that the negative impact to the Fund's value at that stress point will no longer exceed 8 percent?
A. Again, I apologize for being repetitive. But it's obviously a scenario at least to me and my attentiveness where you can always find a scenario where there was an 8-percent drawdown. So implicit my remarks are a scenario that, in my judgment in market conditions and portfolio conditions, it's like a -- likely enough to do so.
Q. Yeah, the scenarios, you -- would you agree the scenarios there that are being talked about are not just any scenario. They're the specific scenarios that you're describing that you stress for, you know, given -- given increments of increases or decreases in price, and -- and

increases or decreases in volume, and you're specifying what those -- what those increments are that you model to, correct?

A. Yeah, and as I -- I think I mentioned earlier, here's my goal to give a flavor and generic description of the process. So those are very good scenarios in a normal, average portfolio composition and in some kind of general market conditions. But, again, not appropriate to apply these kinds of things to every single market condition, appropriate to provide an explanation in terms that are hopefully understandable to the audience, in terms of -- rather than talk about sigmas and VIXs and Greeks, this is a good way to -- for them to understand the techniques I used, and I did use these techniques.

Q. All right. But you would agree with me when you're not in these house calls or the other ones we looked at, you're not talking about, you know, whether you confined any 8-percent drawdown at any, you know, possible scenario. You're talking about particular scenarios of volatility combined with -- with price that -- that you were considering in stressing the Fund, right?

A. But most importantly in these house calls,

I was not providing a prospectus or disclosure document. I was providing, as transparently as I could to sophisticated investors, the description of the techniques I used to stress the portfolio. I didn't feel like anyone was depending on the exact 10, 15, 30 percent, because I didn't think it was actually meaningful to them.

Q. And according to the discussion here, right, the crux of the issue was what your stress test shows, right? I mean, you're stating that you modeled the 8 percent. That's the number you used in stressing the portfolio, right?

A. As I described, that's -- that's the number I looked for, and then identify whether that's a number which you can host -- that is a reasonable scenario, given the --

THE REPORTER: I'm sorry. The last part of your answer cut out. That's a reasonable scenario given the --

THE WITNESS: Portfolio composition and market conditions.

THE REPORTER: Thank you.

BY MR. FOSTER:

Q. So, you know, on page 30, you say, We'll model adjustments. You say, We'll choose the most

economical and effective adjustments to bring us back in bounds so that we can no longer find a stress point that would result in greater than an 8 percent drawdown, right?

A. That's right. That's what the transcript says, yes.

Q. So you're speaking in terms of what is -- what is reflected in OptionVue, not a -- not what is probable or likely in your own judgment, right?

A. Well, again, OptionVue is a tool. So I'm using my judgment how I apply the tool. So it's not a mechanical system. It's not driven by OptionVue. It's me making judgments using OptionVue as a tool to help me with those judgments. And, again, I think that's why I, as the portfolio manager in the house call, describing how I use this judgment and what tools you would, I guess, to -- to make the risk return trade-off.

Q. Isn't the whole point of modeling to model for somewhat extreme events and estimate how the Fund will perform?

A. That wasn't how I used the tool. At least not extreme in the sense of highly unlikely.

Q. Were you using the tool to model what would happen in a worst-case scenario?

A. Not a worst-case scenario, no.

Q. All right. Let's take a look at Exhibit 6. And Exhibit 6 is a transcript of a house call that occurred on March 29th, 2016. If I could direct your attention to page 18 of the exhibit, Mr. Walczak, starting at about line 19.

Have you found that line?

A. Yes.

(Exhibit 6 was marked for identification.)

BY MR. FOSTER:

Q. Okay. Thank you.

So on page 18, beginning on line 19, you stated: Many of you on the phone have heard my description of our risk management. Our risk management is designed to control our drawdowns to 8 percent. And, in fact, our largest drawdown since 2007 has been a little bit higher than 8 percent. I want to say it might have been 8.5.

But that's what we do -- that's what we control to, and we do that with fairly extensive modeling stress testing -- I'm sorry, with fairly extensive portfolio stress testing and modeling. Meaning, we'll stress the impact on a portfolio on a daily basis for 5, 10, 15, and sometimes 20 percent price moves, for volatility moves as high as a VIX

of 45, and we do that across many time frames. And our intention is to, in this case, we do like to front run risk and that is to anticipate if -- what's the worst possible scenario we might experience and are we sufficiently hedged to limit the drawdown in that scenario to 8 percent.
Do you see that?
A. I do.
Q. Is that an accurate description of how you stressed the portfolio using OptionVue?
A. Absolutely. My goal here -- and this is starting to sound a little more familiar. My goal here is to demonstrate the flexibility of how stress could apply 5, 10, 15, sometimes 20, if things are volatile. Sometimes as high as a VIX of 45, lots of time frames. And what's the worst possible scenario we might experience, given the current market environment. And, again, that's not the worst possible scenario that might happen, Black Monday 1987. That's the worst possible with a -- with any kind of likelihood in my estimation that makes some sense to take action of. And that's the intent of this type of description.
Again, I have to continue to emphasize the context here. This is informal Q&A with

sophisticated investors. And I'm open to follow-up questions, if there's some lack of clarity in their minds when they hear me say these things. But that's -- I intended -- I think I accurately described my process.
Q. Right after you say, Our management is -- our risk management is designed to control our drawdowns to 8 percent. You say, And, in fact, our largest drawdown since 2007 has been a little higher than 8 percent.
When you reference your largest drawdown since '07, what were you referring to?
A. I don't recall where the 8-and-a-half percent number came from, but my attempt there was to also make people understand that we were managing to a goal, not a hard line in the sand that they could certainly see 8 percent. But over time we've been recently successful. Fingers crossed that we were able to continue.
Q. When you say that, Our largest drawdown since 2007 is a little higher than 8 percent, were -- are you referring to open option premium, or are you referring to something else there?
A. I don't remember what I was referring to there. It's likely to be an action performance

number, but I don't remember where or how it was computed.
Q. Again, fairly extensive portfolio stress testing and modeling is the reference to OptionVue?
A. Correct.
Q. And here you say that, We'll stress the impact on a portfolio on a daily basis for 5, 10, 15, and sometimes 20 percent price -- price moves. Is that true? Did you do that on a daily basis in the period of 2013 to 2017?
A. I did on a daily basis, as I mentioned, several times now. How -- I apologize. I don't want to be impatient. It's getting late in the afternoon. On a daily basis, I opened up OptionVue. Sometimes there's a need to spend a lot of time on stress testing. Sometimes there was -- based on the portfolio composition and market conditions. But all or nothing could change. So it was a perfunctory sort of look, a quick look, and then on to other business related to the Fund. On a daily basis, I did some form of stress testing.
Q. And you referenced here that the intention is to front run risk and anticipate what's the worst possible scenario that you might experience.
Those are the words you used, right?

A. Again, I apologize for the language, but I had to describe to what I meant.
Q. Okay. Why are you apologizing for the language?
A. Well, I didn't draft this in advance. As I said, I wasn't writing a prospectus. I wasn't choosing my words from a legal or regulatory context. I was just doing my best in a conversational question and answer to describe my techniques.
Q. So in your testimony, what you were actually doing was -- was trying to determine what -- what the worst-probable scenario you might experience?
A. Yeah, again --
Q. Worst possible?
A. You could choose a lot of different words. My intent and my -- process was to evaluate scenarios, use suggestion about the likelihood of a particular scenario, which resulted in 8 percent open option premium. And if I felt that the risk or tradeoff requirement takes some action at that 8 percent level, then I did. And many times I did. Or many times I took the course of action. So, you know, I think there's some accurate description in

the process. Again, the language was not subject to compliance review or -- or meant to be a full description of -- of the Fund or -- or the highest level detail in my process.

Q. Why would a -- I'm not sure I get your reference to a compliance review. Did -- was -- who -- who was the individual at Catalyst that was most familiar with how you ran the strategy? You, right?

A. Well, I wasn't the Catalyst. That was just the guy that hired them on the options --

Q. Well, you're the portfolio manager, right?

A. Yes.

Q. You were the portfolio of the Hedged Futures Strategy Fund at all times relevant to this lawsuit, right?

A. Yes, that's correct.

Q. No one knew the strategy better than you, correct? There was no one at Catalyst, either in compliance or otherwise, that was more familiar than how you ran the Fund than you, right?

A. I would say that's fair, yeah.

Q. What's -- let's see if we can keep marching on here. If you go to -- pull up Exhibit 7, what was premarked as Exhibit 7, which is

a house call transcript for a call that occurred on June 7, 2016. And directing your attention to page 23. While you're getting there, I'm going to publish this in Egnyte.

A. Sorry, what page did you ask me to go to?

(Exhibit 7 was marked for identification.)

BY MR. FOSTER:

Q. Sure. Mr. Walczak, it's page 23.

A. Okay.

Q. Starting on -- starting on line 1. If you could take a moment to review lines 1 through 24.

A. Okay.

Q. Would you agree there's another house call in which you're discussing how you stress the portfolio in OptionVue?

A. Yeah. This is a good example of stressing to the downside. So it's -- yeah. So I agree it's definitely a description finally of downsiders.

Q. Okay. And I'll just -- this one's maybe not as long as some of other ones we have been looking at. So let me just quickly read those lines, starting on page 23, line 1: We're stressing the portfolio using some pretty sophisticated modeling tools, and then, when we find an out-of-bounds situation, so to speak, we then jump

right back in. We have a whole tool set of risk management antidotes, so to speak, in the form of options, contracts, and positions we already use to try and make some money. So we jump in and we move our strikes around, and we buy and sell different put options until that risk goes away. And that's what we do as kind of a risk management overview.

So we like to be in a position and, in fact, we are -- I can't remember, since 2007 that we were not in this position. There's never a scenario where we wake up one day and there's a panic in the market, and we scratch our heads and say, oh, my gosh, we've got to get out of that position. We've got to do something.

We try to be a couple chess moves ahead of that part of the portfolio management, because we modeled that scenario a week ago, and we already took steps so that if the market is down 5 percent tomorrow that was part of our model from a week ago, and either didn't cause us a problem in the model, so we're fine, or it did cause us a problem, and it's already fixed before it happens. That's the type of approach we like to take.

So is that -- is that description of how you stress the portfolio accurate?

A. Yeah, absolutely. As I said, it's a description of how we prepare for downside volatility. In this particular one, referencing the drawdown of 2007, which is the downside drawdown, panic in the market, and down 5 percent tomorrow. So that's -- I think someone must have asked -- I don't see what the question was, but someone must have asked about what happens if there's a crash, and that was my response.

Q. The reference to out-of-bounds situation, what does that -- what does that mean?

A. Yeah, again, I'm just talking about looking at, once again, open option premium. This one would be on the good side probably, but -- and talking about exceeding that open option premium metric that we pay attention to.

Q. And so when you say you'll jump right back in, you're describing adjusting the portfolio through trading, correct?

A. Yeah. This -- in this example, yes.

Q. And moving strikes around, in particular, is one thing you mentioned?

A. Yes.

Q. All right. Is that the same basic process -- is that the same basic process described

in the other calls we reviewed?
A. Like I said, this is the downside scenario. And, again, I know that we've been, once again, taking small portions of 30-page or 25-page documents, so context is everything. I don't know what question was asked. I don't know what the tone of the conversation was. But this is a good example of describing what would happen in the market panic, which must have been the question someone -- somewhere in here.
Q. Well, for the above-the-market call strategy, was -- did this same basic sentiment ring true? Did you try to be a couple chess moves ahead from a risk management perspective?
A. Yeah, that was my intention -- it was my -- that was my goal for sure.
Q. And you -- and you -- and you did that by -- via modeling scenarios in OptionVue that could result in a drawdown in excess of 8 percent, correct?
A. The open option premium is what I modeled as I testified, yes.
Q. Okay. Let's go to the next exhibit, sir, Exhibit 8. I'm sorry. Hold on. I think -- let me make sure I have the right one. Okay. It looks

we're -- I'm sorry, I have Exhibit 7.
A. Oh, did you want -- I'm not sure. I think I've got 8. Did you say you say 7?
Q. Yeah, sorry. Bear with me one moment.
MR. KOPECKY: We were just on 7, I think.
THE WITNESS: That's what I thought, too.
MR. FOSTER: Okay. We have 7. All right. Good. Sorry, I just haven't moved it into the marked exhibits folder. So, yeah, let's focus on 8, please.
THE WITNESS: Okay. I've got 8.
(Exhibit 8 was marked for identification.)
BY MR. FOSTER:
Q. Okay, 8 -- 8 is a house call -- a transcript of a house call dated December 13, 2016. And if you direct your attention beginning -- beginning on page 40, line 23 of the transcript. And at -- starting at about line 23 on page 40, there's -- there's a question posed by a listener, someone that's called in, and then your response.
Do you see that?
A. Yes.
Q. And it says -- the question reads: A couple of times you've mentioned that, you know, you're always worried about capital preservation,

and you've mentioned like an 8-percent loss. If you hit an 8-percent loss at any point in time, you know, I'm just interested in what exactly would happen.
And then your response follows. Do you see that?
A. Yes.
Q. Okay. And you -- you know, the first part of your response reads: Yeah, what we generally do is we model our exposure. We stress both portfolios looking out at various price points and volatility changes up and down in -- certainly in the S&Ps, and then in each of the commodity markets that we trade in with the goal of holding that loss to 8 percent.
And we do that by identifying where -- you know, that's the one predictive thing we do. It's on the risk side. We continue to talk about how we react to the markets -- to markets in terms of entering positions and adjusting positions.
We do try to anticipate market moves in terms of the risk presented to the portfolio. And what that amounts to is we do have a hard stop at 8 percent. We would flatten the portfolio roughly at 8 percent. The portfolio at 8 percent.
I want to stop there for a second. When

you say that, We have a hard stop at 8 percent, what do you mean?
A. Yeah, you know, again, this is a little bit back in time, but there's -- the other way we use the 8 percent number is if -- if we somehow aren't successful on being forward looking adjustments and we do hit that 8 percent open option premium, then we do our best to flatten the portfolio. I think I mentioned some -- some slippage and, you know, talk about 8-and-a-half, 9 percents or thereabouts, with the goal of achievements. So 8 percent is the number that -- like, hard stop means, look, at 8 percent, we can't start. That's the point in which my judgment goes out the window about likelihood, and then we have to take very aggressive action.
Q. Okay. Well, you say here, We do try to anticipate market moves in terms of the risk presented to the portfolio, and what that amounts to is we do have a hard stop at 8 percent. So is the hard stop at 8 percent referring to anticipating market moves, or you're referring to what happens when there is an actual move that results in an 8-percent drawdown.
A. Well, again, this is a realtime off the

Page 209

cuff. I didn't go back and edit words. So did I choose the right words? I don't know. What it means is I think it's very consistent and still is. If we hit the 8 percent open option premium, if we hit an 8-percent drawdown, we are going to take some pretty aggressive action.

Then, again, anticipating market moves, it's back to the old scenario of looking forward and saying, Let's likely -- let's try to anticipate what they say. Trying to sense in terms of modeling, if we see something happening out there, we'll get in and take action, if necessary. Maybe -- maybe -- sometimes no action is action, sometimes it's unlikely. But at the end of the day, when we hit the 8 percent, then we can't start talking about likelihood anymore. We've got to do something.

Q. All right. So then scrolling down in the transcript, what -- what follows is some discussion of why that -- that 8 percent figure was chosen.

Do you see that?

A. Yes.

Q. Okay. So skipping ahead at -- to line -- page 42, line 22, you then go on to say: But the bottom line is we look ahead and stress the portfolio and we identify a condition that is out of

Page 210

bounds, we'll hedge that right now.

And so as a result -- as you say what happens if the market moves 10 percent -- whatever market it is -- and if that gives us an uncomfortably large loss, we'll go in and hedge that thing.

Now that 10 percent move might never occur, but if we even -- if we get even 3 percent in that direction, then automatically we have that additional cushioning.

And in that circumstance, then we'd look again at the model and we'd say, oops, we still have a problem. We'll hedge some more.

So it's a very gradual type of hedging scenario. We've never really had to liquidate the portfolio or to neutralize it because our ongoing hedging techniques -- we use hedging instruments. That's what we trade in. That's what options are really built for.

So our hedging techniques allow us to cushion price movement and we're never in a situation where we have sort of a hard stop loss, and we're sitting just waiting for that 8 percent to get triggered and then we get out because we're constantly hedging.

Page 211

That's the first thing we do every day is to identify risks and tune up our hedges if they're not sufficient.

And that allows us to avoid that hard stop and still maintain our drawdown discipline.

Okay. Is that an accurate description of how you stress the portfolio in OptionVue?

A. Yeah, I think it absolutely is. It's -- in fact, if we're looking ahead -- as I've described all day today, we're looking ahead. We hedge if we see something that is a likely risk.

And -- and as I said, it's not sufficient in my judgment, but I think that's kind of implicit, then we'll go in and do some more. I think that's accurate. That describes our process.

Q. Okay. But in what I just read, the word, likely, appear anywhere?

A. Again, I have to keep repeating this, because you're asking about specific words, like we're reading a disclosure document. This is a off-the-cuff description, which I -- certainly my meaning is -- was very accurate. I didn't parse words. I didn't rehearse it. I didn't write it out. I didn't run it through compliance.

If the words were confusing, there was --

Page 212

there was -- no one asked for further explanation. But that's what I meant. I didn't mean to use language that would fit in a prospectus, especially when they were advised to look at it.

Q. Right. The -- whether you scripted it out or not, I mean, the words that -- that reached the listeners' ears, I mean, house calls, it was important for those words to be accurate, correct?

A. I think they were accurate.

Q. I didn't ask you if they were accurate. I asked you if it was important that they -- that they be accurate, correct?

A. They accurately describe what -- what I did in a general sense, and very specifically what I was doing at the time of the call, because I was on the call to talk about what we were today. But in general, I'm -- you know, this describes, I think, very consistently my process.

Q. All right. But focusing on the beginning of 40 -- page 42, line 22, when you say, when you were talking about the bottom line, it's -- we look ahead, stress the portfolio, and we identify if a condition is out of bounds, you'll hedge that right now, okay?

So when you say, Identify a condition that

is out of bounds, what does that mean? What are you referring to?
A. Well, I meant at the time, what I consistently described, and, you know, we only looked at, you know, very, very tiny samples of house calls. But in those calls where this topic came up, I've identified that 8 percent open option premium as the -- the number I use so that I had a number, rather than just a gut feel. And then I had a number to look for in scenarios that made sense, given the market conditions in the portfolio composition.
Q. And when you're talking about here, what happens if the market moves to 10 percent, and that gives us an uncomfortably large loss, we'll go in and hedge that then. You have knowledge that that 10-percent move never occurred, right?
A. Yeah, that's -- yeah, that's what I said, sure.
Q. And you say in here that the first thing -- strike that.
Yeah, you say in this page you say that the first thing you do every day is to identify risk and option reviews.
Do you see that?

A. Yes.
Q. Okay. Is that -- is that true? Is that the first thing you did every day in managing the Hedged Futures Fund?
A. Yeah. So, again, I've got to repeat. I think -- so turn out on OptionVue every day. First thing I look at is the portfolio. Some days market conditions are quiet, nothing has changed in the portfolio. It doesn't take very long to take a quick glance at the risk profile to see that it hasn't moved. Other times, it's volatile, so it actually might be required. I'll have to model a lot of different scenarios to understand what action and how urgent. So the stress test occurs. Sometimes it's very quick, sometimes it's more lengthy. Again, depending on the portfolio deposition and market conditions.
Q. From what you recall, the February 2017 time period, there was a large drawdown in the Fund, correct?
A. Correct.
Q. Okay. And that -- and that sort of coalesced in mid -- midway through the month; is that right?
A. I think so, yes.

Q. So in the first part of February 2017, is this -- was this your process? As described here, was the first thing you did every day to identify risk to shoot out hedges, if they're not sufficient?
Did you do that in February -- early February 2017?
A. I do remember at that point in time our risk was concentrated in nearby options. That risk didn't change. The market was extremely quiet. So I certainly opened the Screen every day. At that point in time, I had just completed a multimonth series of derisking the portfolio. My choice at that point was that with a short time to expiration that the best risk return tradeoff was not to take action.
Q. All right. And that -- that decision proved to be a costly one, right?
A. In -- in hindsight, that judgment turned out to be incorrect.
Q. The Fund held a lot of risk at that time, true?
A. I'm not sure what you mean by risk.
Q. While there was -- given the concentration that you described in the time the -- the positions were sensitive to movement in the underlying -- the

price in the underlying asset, the stock futures contract, right?
A. What I recall based on the metrics we used to operate the Fund is that most of them, if not all of them, were at the very low end of their range.
Q. Well, I'm not -- put aside the risk metrics. I'm talking about what you -- what option you shared. Were you stressing a portfolio on OptionVue? What did -- what did OptionVue tell you about potential risk of -- to the Fund?
A. What I recall was in the -- the risk -- there was some concentration on the portfolio, and there was some concentration of risk in the portfolio when I did my evaluation, and it was in options expiring in roughly two weeks.
And when I looked at the likelihood of market move that would cause that 8 percent drop down, it was very low. And I also knew at the time that with near-to-expiration options, the risk of decline fairly rapidly day by day. So these were some of the judgments I made about how to manage that risk. But overall, the portfolios were at variable level of positions critical margin requirement from the collateral from the brokers, and the option premium was low.

Q. Okay. Why don't we -- can you pull up what has been premarked as Exhibit 9, Mr. Walczak? And this is a transcript of an October 25, 2016, house call.
A. Okay.
(Exhibit 9 was marked for identification.)
BY MR. FOSTER:
Q. All right. So if I could direct your attention to page 30, line 6.
A. Yep.
Q. Let me just catch up with. So starting line 6, a participant asks: Hi, Ed. It's my understanding that as a goal you shoot for about a maximum drawdown of 8 percent. Specifically what happens to the Fund if that were to occur?
And you begin your response by saying: So -- and you're correct, that is the goal of our risk management process and protocols.
Do you see that?
A. I do.
Q. So that -- you agree that you manage the Fund with a goal of -- of limiting any drawdown to 8 percent?
A. Yeah. I'm -- I'm pleased that for Jessica who asked the question, I understood it was a goal,

and I guaranteed it, because I'm trying to make people understand there were no guarantees in this, and there's all kinds of -- but he understands it's a goal. And absolutely repeating that, because that was our goal of what we're doing.
Q. Okay. And it's -- it's a goal, not a guarantee. Because as you say further down at line 13, We're not using a standard sort of stop-loss, right?
A. Correct.
Q. Okay. Was there -- whether standard or not standard, did -- was there any form of stop-loss that you're aware of that you see used in managing the Hedged Futures Fund?
A. We used a -- a concept of the stop-loss. Meaning, when we hit that 8 percent, if my -- my judgment in looking at scenarios and getting ahead of risk turned out to be incorrect or flawed, then -- and we hit an 8 percent number in that open option premium, or even in a grueling 30-day drawdown period, then that was our -- our trigger to go in and do the best to flatten in the portfolio that we could.
Q. What's your -- how would you define the term stop-loss? What's your understanding of that

term?
A. It's a -- it's a trigger point. I think you'll find in most execution firms that allow you to enter a stop-loss, there's a -- there's a pretty good definition in there that says, Hey, when this triggers hits, we'll enter the order, but it's a market order, and there's no guarantee at what price to be filled. So I think that's a pretty good -- pretty good term here. At least the same way, we did it at a portfolio level. There was -- there was no way to enter a portfolio stop-loss order in the marketplace. But when we hit that level in the Fund, then we would go in and treat it like a stop-loss. Meaning, we'd go in and start to very aggressively exit positions and do a flatten risk exposure as best we could.
Q. But have you treated it like a stop-loss, or was it, in fact, a stop-loss, or was -- you just said -- as you state here there's no standard stop-loss as you utilized with respect to this portfolio, correct?
A. I'm not sure exactly what you're asking.
Q. Well, did you, in fact -- I mean, your goal -- you made the point of -- of noting that in this discussion that, look, 8 percent max drawdown

is aspirational. It's a goal. Doesn't mean you're going to be able to achieve it, right? And, you know, you didn't -- you didn't, in fact, have any way of actually limiting losses to 8 percent, did you?
A. No. We had no way of having a guaranteed limit on the -- the lawsuit portfolio.
Q. In February 2017, when you approached that 8 percent threshold, it wasn't just a little bit of slippage, right? There was substantial slippage from that 8 percent number, right?
A. Yes, there was.
Q. And were you able to -- were you able to go in and flatten risk at that time?
A. We did our best, but we were unable to do it.
Q. Is that one illustration of how you -- in fact, there were no stop losses that could control or limit a loss to 8 percent?
A. That's certainly an example. As I said, that's consistent with the concept of stop-loss order. And I think that's why -- that's why I used the terminology.
Q. Okay. Did you -- did you use that terminology? I mean, here, in this house call,

Page 221

you're actually saying we're not using a sort of standard for the stop-loss. So were there times when you -- when you did, in speaking with financial advisors or others, used some reference to a stop-loss?
A. I think there was a investment process document that talked about stop-loss in the portfolio level.
Q. Okay. If you can turn to what's been premarked as Exhibit 10, Mr. Walczak.
A. All right. I've got it.
(Exhibit 10 was marked for identification.)
BY MR. FOSTER:
Q. Okay. So Exhibit 10 for the record is Bates number CFTC3_00032463. And there's an e-mail dated August 24th, 2014, from you to Chip Hano.
Do you see that?
A. Yes.
Q. Okay. And who is Chip Hano?
A. He was a -- or is maybe still, I don't know -- a Catalyst wholesaler.
Q. Okay. Was he an internal or external wholesaler? Are you familiar with the difference?
A. I sort of understand the difference. I believe he was external. So he actually went on the

Page 222

call.
Q. Okay. And take a moment to -- to review the documents. I've got a couple questions.
A. Okay.
Q. So in this exhibit, is Mr. Hano -- Hano forwarding some questions from a financial advisor and asking you to weigh in?
A. Yes.
Q. Okay. And he forwarded this information to -- to your -- to a Harbor Financial e-mail address and a Catalyst Mutual Fund e-mail address. Were those both e-mail addresses that you used in this time period?
A. Yes.
Q. And then Mr. Hano writes that this is from Shepherd Kaplan, 14 billion AUM.
Do you understand the reference to Shepherd Kaplan?
A. I -- I -- I don't actually. I don't know what that is, an individual, a fund. I'm not sure.
Q. Okay. In your response to Mr. Hano where you say, See below. And then you also say, Attached are examples of typical Fund called the butterfly and put calendar spread.
And if we scroll down to the -- this

Page 223

e-mail to Vann Taylor on August 13 at 1:25 p.m.
A. Okay. Got it.
Q. Okay. And it goes -- and that goes from sort of the bottom of the first page -- of the second page of the exhibit -- of the PDF. And then there's some -- there's some language that's typed in red font.
Do you see that?
A. Yes.
Q. Okay. Are those your comments to the inquiries being made by Mr. Taylor?
A. I really can't tell. As I read it, they're consistent with things I've described, but I can't tell from this e-mail chain who is writing what, to be honest.
Q. Do you have -- was this something you would do on occasion, you know, respond to questions by going down as one of the underlying e-mails and -- and sort of typing over in -- and editing those in red essentially?
A. I mean, I didn't have a lot of back and forth with individual salespeople or advisors. That's not my thing to do certainly, so I can't say there's a typical thing. Again, I just -- I can't tell from looking at this document who did the red

Page 224

or -- to be honest. I mean, the body -- the body up top is from me talking about some graphs they must have sent.
Q. Well, the risk management structure -- down in the message from Mr. Taylor where there's language that says, Risk management structure. Maximum loss, worst case scenarios, and the structure around trading, the commentary in red that follows that, do you think those are your comments?
A. I mean, it looks to me like it's an e-mail from Vann to Chip, so whoever Vann is. I don't know. That name doesn't ring a bell. So it's -- it's clearly his response. Where he got it, I don't know.
Q. Well, isn't Mr. Taylor writing that, We need -- we need to understand, and then it says, Risk management. Maximum loss, worst case scenario, and the structure around trading. And then there's information provided on those topics?
A. Again, I have no idea, looking at this document, who is writing to who. The only thing that looks weird to me is that I'm attaching -- somebody asks me for something, I'm attaching some positions structures and explaining what they are. That's all I have any confidence in looking at this.

Page 225

Q. Okay. It says that position risks are identified and hedged at entry. Portfolio risk stressed daily for price excursion plus 5 percent, plus 10 percent, minus 5 percent, minus 10 percent, minus 20 percent, volatility excursion VIX equals 10, equals 20, equals 30, time horizons inclusive of longest dated position expiration. Portfolio stop at 8 percent drawdown. More detail needed on a call.

Isn't that describing stress testing of the nature that you did in OptionVue?

A. Sure. I mean, your question was did I write it, I have no idea. Did I write this response and someone interpreted my comments, summarized them, or whatever, I don't know.

Q. All right. Well, regardless of who wrote it, is the information accurate?

A. Again, this -- this marries some of the questions I made and answered some question -- questions on the calls. But, again, I mean, I think I offered up a -- as I normally did, I would have had ample time -- at least the opportunity to discuss it in a little more detail, because I didn't feel like you could get an accurate summary in a short thing like this. So I don't know if Vann was

Page 226

impatient and summarized my comments, as well as my offer for a call whether -- if it came from us. I just can't say.

Q. Where it says that the strategy is on average 75 percent model driven and 25 percent discretion -- is that accurate?

A. I do recall making that distinct -- I do recall making that distinction when asked, you know, emphasizing -- when I made the distinction, I made it saying the 75 percent model driven was larger than entry, and the 25 percent discretion was profit-and-risk adjustment. I do recall making those comments at the time.

Q. And you recall making those comments in what -- what context?

A. I don't remember whether it was a house call, informal question from an advisor or wholesaler. I just remember that's a -- that's a split that I got asked about, and it's a common question for people to say, Hey, is this a mechanical system? No. Is it, you know -- what percentage is it mechanical versus your discretion? And I typically use that split and described further that, again, entries were lots and lots of options analytics. Exits for both profit and risk were much

Page 227

more of my discretion.

Q. Okay. So understand that you made this distinction. And so is it your testimony, also, that that -- that statement is -- this -- this description of the strategy, is that accurate, in terms of what -- what a ratio of model driven to discretion?

A. Yeah. And, again, it's -- it's an accurate conceptualization. Is it precise, I don't know how you define 75 and 25. Once again, like a lot of my comments, trying to give people a general sense for how the Fund was run. And so what this really means is, yeah, the majority, and not 55, but 75, however you define that, use of model, pretty great, big load of discretion involved as well.

Q. Okay. If you could turn to what's been premarked as --

THE WITNESS: I apologize, but the water's catching up to me a little bit here.

MR. FOSTER: Oh, yeah. Let's take -- let's take a quick break.

THE WITNESS: Okay.

MR. FOSTER: Thanks.

VIDEOGRAPHER: Going off the record at 4:25 p.m.

Page 228

(Recess taken.)

VIDEOGRAPHER: We're going back on the record at 4:37 p.m.

BY MR. FOSTER:

Q. Mr. Walczak, if you could now look at what's been premarked Exhibit 25.

A. Okay. Got it.

(Exhibit 25 was marked for identification.)

BY MR. FOSTER:

Q. Okay. This document, there's a Bates stamp Catalyst_003_00192. There's an e-mail exchange dated January 2nd, 2017. Between you and a Mr. Brandon Schwulst, S-c-h-w-u-l-s-t?

A. Yes.

Q. And is -- was Brandon a external wholesaler at Catalyst?

A. Yes, he was.

Q. Okay. In this -- in this e-mail chain, is Mr. Schwulst forwarding on a question from a financial advisor out in the field?

A. It looks that way, yeah.

Q. And Mr. Schwulst writes that this individual, Mark, whom we went to the Red Rocks concert with.

Did you go to a Red Rocks concert with

Mr. Schwulst?
A. I did. I remember that.
Q. Okay. And when was that?
A. That I don't remember, but I remember going to -- Brandon was in Denver, and I remember going to a Red Rocks concert with him.
Q. Okay. And who else was with you and Brandon?
A. I didn't remember who else was there, but he refers to someone named Mark, and I guess he was along.
Q. And Brandon writes that he's -- that Mark was on the call Tuesday and tried to ask a question, but the line wouldn't unmute. So if you could give me some feedback for him, I really appreciate it. And then you see the question here, which is: If the S&P 500 continued to rally 2400, for example, in Q1, how would that negatively impact our current position and what moves we would need to make to manage risk? What potential drawdowns could a move like that cause?
Do you see that?
A. Yes.
Q. And in your response to Brandon, among other things, you write that, We are in the market

every day responding to movement and adjustment positions.
Do you see that?
A. Yes.
Q. And then further on, you write, I wish I could provide a rock solid max drawdown, but obviously can't guarantee anything. December printed roughly a 4-percent drawdown and we are currently drawn a little over 6 percent from our high water mark. Do you see that?
A. Yes.
Q. Okay. Did -- in December -- was there a 4-percent drawdown in December of 2016?
A. I think December was a down month, you know, channeling month, and that sounds about right to me.
Q. And when you write here that -- when you're referring to a 4-percent drawdown in December, I want to make sure I understand what -- what are we talking about when we're talking about drawdown?
A. Again, I don't know the specific measure, but just recollection-wise, I'm guessing that was the return for the month of December.
Q. Okay. Well, do you, you know, have any

reason to doubt you wrote the words here, December printed roughly a 4-percent drawdown?
A. No.
Q. Okay. And have you made comments like that in the course of managing the funds to describe, you know -- referring to a drawdown in a given month?
A. To be honest, if you'd ask me if I made this comment without showing me the e-mail, I wouldn't have remembered it, so I -- I don't really remember.
Q. Well, not -- not this particular comment, but just would you ever say that, Well, we have X drawdown for -- in a given month?
A. Again, I don't -- I don't remember. Like I said, if you'd ask me that question without showing me this, I would tell you the same thing. I don't remember talking about December. I don't know if I made those comments before. I just don't remember.
Q. Well, when you used the word drawdown, you know, in managing a fund and talking with wholesalers, what did you mean?
A. Well, it meant -- it looks to me, especially from this time, I could have meant

different things at different times. This context sounds to me like I meant in December, we lost 4 percent for the month.
Q. So from -- from of the beginning of the month to the end of the month, there was a 4 percent decline in the NAV in the Fund?
A. Yeah, that's what I'm interpreting this to be, yeah.
Q. Okay. And then you go on to say, We're currently down a little over 6 percent from our high water mark. Do you see that?
A. Yes.
Q. Okay. We were talking about high water mark a little bit earlier. And that refers to what?
A. Well, it refers to the highest value of the Fund's ever achieved.
Q. Okay. And you don't recall what the Fund's high water mark was?
A. No.
Q. Earlier you told me that you didn't really focus on where the Fund stood with respect to its high water mark, but agree in this -- in this e-mail you're given that data point?
A. Yes.
Q. Was -- the 8 percent, was there a

significance to an 8 percent measurement from the high water mark? Did you manage the Fund to avoid an 8-percent drawdown from the funds or greater-than-8-percent drawdown from the Fund's high water mark?

MR. KOPECKY: Asked and answered.

A. I have answered that before. No, I didn't manage an 8-percent drawdown from a high water mark.

BY MR. FOSTER:

Q. Okay. Let me go to an exhibit, which has been premarked as Exhibit 11. And Exhibit 11 refers to Bates labeled number SEC300032436. And this is an e-mail chain, and e-mail on the top is from you, Mr. Walczak, dated August 26, 2014, to Mr. Jerry Szilagyi and an individual named Erina Ford.

Do you see that?

A. Yes.

(Exhibit 11 was marked for identification.)

BY MR. FOSTER:

Q. And you write, See my comments below. That's your message, right?

A. Yes.

Q. Okay. And are your comments below the ones in the red font?

A. I think probably so. Again, I don't remember. So -- but that looks like what it is.

Q. Okay. And Erina Ford has an e-mail address at raymondjames.com.

Do you see that?

A. Yes.

Q. Okay. Do you -- do you know Ms. Ford?

A. Don't recall the name, no.

Q. And was -- in her e-mail to Mr. Szilagyi, among other things, she writes that, I would like to understand the strategy better so we can maybe revisit our decision on whether or not we want to offer the Fund in our platform.

Do you see that?

A. Yes.

Q. Okay. Was the Hedged Futures Fund at some point offered on the Erina James platform?

A. I have no idea.

Q. Were you, you know -- during the time you were managing the Fund, were you familiar with what platforms it was offered on?

A. No.

Q. She says that -- she writes, again to Mr. Szilagyi on her call with Ed, He mentioned an 8-percent max drawdown limit that is carefully

monitored. Can you provide more details on the nature of this risk mitigating tool and illustrate how perform various marketing environments.

Do you see that question?

A. Yes.

Q. Okay. And then you believe that you provided the response in the red font, correct?

A. Yeah, I think I -- I -- I probably sent that -- it looks like I sent it straight to her, which is unusual, but that's what the e-mail looks like.

Q. Okay. And why do you say that would be unusual?

A. Well, typically, I -- you know, if there's a question like that, I'd send it. You can see it came in to Jerry. I would typically send it out through Catalyst so they could pass judgment on whether or not it was the right language and the right thing to be saying.

Q. Okay. So then the response here in red is that individual position risks are identified. Then in a parenthetical, it says, time price volatility, closed paren. And hedged with counter balancing options at entry. Individual positions are aggregated to an options pricing tool that models

portfolio value stress by plus 5 percent, plus 10 percent, minus 5 percent, minus 10 percent, minus 20 percent, price excursion, VIX plus 10, comma plus 20, across five times horizons extending to the portfolio's longest dated options expiration. And there -- stop there for a moment. You're describing -- the option pricing tool you're describing is OptionVue, correct?

A. Yes.

Q. And then you go on to say, Absolute drawdown of 8 percent from high water mark requires flattening of risk, no discretion allowed.

Do you see that?

A. Yes.

Q. Okay. But a few moments ago, you told me that you did not manage the Fund to an 8-percent drawdown from a high water mark. So what did you -- why did you write this?

MR. KOPECKY: Objection. Form. And argumentative.

A. Well, because I managed to -- the open option premium number, which, in my experience, translated to limiting drawdowns.

BY MR. FOSTER:

Q. Was there a -- a risk control or metric

that was an absolute drawdown of 8 percent from high water mark requires flattening of risk, no discretion allowed?

A. Catalyst and I modified that metric, as I mentioned to a 30-day rolling 8 percent decline, NAV, which we used them in conjunction with the 8 percent open option premium. I modeled to the 8 percent open option premium. One of the metrics we began to monitor was an 8 percent rolling 30-day drawdown. And by the way, the reason for that was a discussion in Catalyst, and they determined if you flatten the Fund, what do you do next? It becomes a fixed income fund. So you're going to, at some point, be back on the market. So an 8-percent drawdown over a relatively short period of time. We would necessitate some aggressive action. But from a high water mark, it's probably not a good way to measure in the real world what you actually do, so that was the discussion we had in Catalyst.

Q. Okay. And when did that modification occur? Did it change from an 8-percent drawdown from a high water mark to something else?

A. Well, I don't know. Even at this time, this was -- this was something that wasn't in a formal -- I think it was the formal risk measurement

at that time. But that -- that was our best memorialization of some of the metrics. That was just that risk metrics that we used.

Q. Okay. You don't -- you don't recall when that occurred, though, is that what you're saying?

A. Right.

Q. Do you recall what year? Do you recall what specific date or month?

A. No, that was -- I mean, that was an evolution of the metrics over time. And so a number of them were modified. I mean, this continued from 2013 until I left Catalyst. There was quite a number of modifications in the risk metrics. So it's just not clear in my mind exactly when different things happened.

Q. When this -- when this modification occurred, whenever it occurred, what -- what kind of document reflected this rolling one month or rolling 30-day measurement?

A. Well, as I said, that -- that drawdown metric was in the -- the daily risk metric reports, which -- yeah, I don't remember the exact time frame of the evolution, maybe 2016 is when we had a preformal reporting of those metrics, maybe earlier, but I don't recall.

Q. Okay. We saw the prior exhibit, right, you were -- in speaking with Mr. Schwulst, it's now January 2017 time period with Exhibit 25. And you were still talking in terms of -- or conveying where the Fund was from the high water mark, correct?

A. Yeah. I think I responded to a specific question from him about performance. And so I went back and looked it up, but that was in the regular reporting tool that we used.

Q. So when the -- so when there is this modification that you're referencing, it's the daily -- the daily risk report or risk metrics that recorded this information mentioned. You know, they mentioned 80 -- 8 percent in 30 days. Would that -- would that tell you when -- if the change had already happened?

A. Yeah. I mean, if -- whenever we could find a risk report that started to talk about 8 percent in 30 days is a good indication of when we formally agreed to make that move. We may have formally done it earlier. I just don't recall completely.

Q. Okay. If you could turn, Mr. Walczak, to what's been premarked -- let me make sure I have the right document. 28, Exhibit 28.

A. Okay. I've got it.

(Exhibit 28 was marked for identification.)

BY MR. FOSTER:

Q. Looking at the first page of this document there is, among other Bates number, a Bates number SEC_01_0023787. Do you recognize this document?

A. Yes, it's -- there were a number of versions of this one, but I recognize, generally, this document.

Q. Okay. And the -- the -- there's actually two e-mails in this chain, so to be clear the top e-mail is actually from Mr. Szilagyi, dated February 14th, 2017, to various folks, and you were not copied on that -- that e-mail. And he's forwarding an e-mail from you a few hours earlier on February 14th, 2017. So you're -- focused on your e-mail, it's from you to Mr. Schoonover, with a CC to Mr. Rios and Mr. Szilagyi with the subject, HFS Update.

Do you see that?

A. Yes.

Q. Okay. And HFFS -- HFS refers to the Hedged Futures Fund?

A. Yes.

Q. Okay. And you -- the only words in your

Page 241

message are, Feel free to edit. And then there's an attachment.
Do you see that?
A. Yes.
Q. So the attachment is a document entitled, Catalyst Hedge Futures Strategy Fund Update: February 14, 2017.
MR. KOPECKY: Sorry, guys, to interrupt, but Ed's e-mail doesn't say there's an attachment. I see that Jerry's does. Ed's does not.
MR. FOSTER: Okay.
MR. KOPECKY: So I just -- I don't know why that is or what happened. But I'm not agreeing then that Ed had -- had an attachment or this attachment unless or until we figure out what's going on. That's all.
Ask your questions, Mike. But that's odd to me that there's not -- it doesn't say attachment in Ed's e-mail.
MR. FOSTER: Okay. So why don't we start for the false start. Why don't we go to what's been premarked as Exhibit 29, which should I think should address your concern, Mr. Kopecky. This is the e-mail without the forward from Mr. Szilagyi.
MR. KOPECKY: Okay. I see in that one so

Page 242

this is him sending this attachment to Schoonover, Kim, and Jerry. All right.
(Exhibit 29 was marked for identification.)
BY MR. FOSTER:
Q. Okay. So do you have Exhibit 29 in front of you, Mr. Walczak?
A. 29, I do.
Q. All right. You do. Okay. Sorry. We're just shifting gears here real quick.
And this document has a Bates stamp of SEC010000276. This is your e-mail to Mr. Schoonover, Ms. Rios, Mr. Szilagyi, at 3:09 a.m. on February 14, 2017. Is this what your -- you recognize in the prior exhibit, this e-mail?
A. Yeah. The only comment I'll make is I remember this, because it was -- I was asked to write a -- excuse me -- an update subsequent to the large drawdown we had in February. And I -- I recall, because it was fairly considerable. There was a -- the edits done -- you know, it was my habit to send this stuff to Catalyst and let them decide what they actually wanted to say. And they did a pretty decent edit to this one, so I don't know which version this is.
Q. All right. Well, isn't this a version

Page 243

that you're sending to them and inviting them to edit?
A. Well, I'm not 100 percent sure. I just remember very specifically that there were two versions to this, and they were more materially different than normal for Catalyst to edit something I sent to them.
Q. Okay. Do you -- do you have any reason to believe you didn't -- you didn't write the document that's attached to this e-mail that you're asking or telling folks they can feel free to edit?
A. Well, like I said, I -- maybe I missed the confirmation in number 29. If that's proof that it came from me, well, it came from me. But, like I said, I very specifically, because of the time frame and the activity around the drawdown, remember the communications effort Catalyst had begun to do some pretty material editing to things in this document in particular. So that's all I would say.
Q. Sure. Sure. Sure. If we look at -- back to Exhibit 28, and Mr. Szilagyi is forwarding your e-mail to various folks. And he writes, Let's review and make sure we are comfortable with this before we release to the team.
Do you see that?

Page 244

A. Yes. So, again, it wouldn't be unusual for -- for me to forward a document, for Jerry to have somebody to look at it, edit it, and then Jerry send it out to others, and say, Okay, here's what we think our final version is. What do you think? So -- so, you know, again, it sounds, though, that may be the case here. I'm not sure.
Q. What -- what makes you -- what is this -- what about this suggests to you that in Exhibit 29, this is not your document that you wrote? What did he ask you in any way, shape, or form that -- that somehow this has already been edited by somebody else?
A. I'm not suggesting it has. I just remember that this document sticks in my memory. The edit sticks in my memory, and I can't tell which version this is. That's all.
Q. Okay. And in this -- in this update, you provide an explanation for the drawdown that occurred in February 2017 at least up to this point; is that right?
A. All right. Let me take a moment to read it.
Q. Sure.
A. Okay.

Q. Okay. So back to my question. Is that what you're doing here, you're -- you're explaining why the drawdown occurred, in your words?
A. Yeah, that was the first pass quick assessment, yes.
MR. KOPECKY: Note my objection that that misstates exactly what you said here in the document itself. So it misstates the document, mischaracterizes it, objection to form and foundation.
BY MR. FOSTER:
Q. Do you see that -- so after the first -- one, two, three -- the first four paragraphs talking about the NAV volatility and the conditions surrounding that volatility. Do you see that? Is that fair?
A. Which paragraph should I be looking at?
Q. Just the -- before the -- the paragraph that precedes, What have we done.
A. The two paragraphs that you want me to look at, or just the one right above, What we have done?
Q. Well, why don't you tell me what -- what -- what are you saying in the first several paragraphs of this document?

A. Like I said, I wanted to give -- at the request, I wanted to give Catalyst a quick strike kind of assessment. I didn't have a chance to do a lot of the analysis. Some of the factors, they were interested in some communication, so I wrote something relatively quickly to describe what I felt was responsible for the, you know, internal for the Fund, what was responsible for the drawdown and volatility.
Q. So under the subheading, What have we done, the second bullet point, first sentence: We activated an additional risk metric that we have been testing in response to the onset of heightened Fund volatility. This metric will force earlier and more aggressive and adjustment actions to help avoid the impact of expiration related volatility.
Do you see that?
A. Yes.
Q. Okay. So was that true? Was there an additional risk metric that was activated on or about this time mid-February 2017?
A. I don't recall whether we formally did or did not right at that moment. I don't remember.
Q. Well, the document says you did, right? It says, We activated an additional risk metric --

A. Well, that's why I said Catalyst. You know, that was probably our intention, what we formally did or not. I expected them to either say, Okay, we're not going to do it and let's take this out, or we're gonna do it. But at some point, you know, there must be a reason for me to write it, but I don't remember did we do it right that day. Again, that's why I sent it back to Catalyst, not to external parts.
Q. Whether you did it on this day, the next day, a week later, do you know -- or not at all, do you -- do you know what additional risk metric is being referred to?
A. I -- my best guess, we did talk about a number of metrics. My best guess would be delta, but that's only a guess. Eventually we did delta. This might have been a concentration metric that we tested and later discarded. We were testing delta at the time. We eventually included delta, but we also had a number of meetings down into March before, I think, we formally adopted delta. But, again, I don't -- I don't recall.
Q. Well, if we scroll down further, Mr. Walczak, in the document under the heading, What this means going forward, the first bullet point

reads: The strategy is intact. As we do following any drawdown, we have made changes to try to improve risk management while maintaining the return profile the strategy has delivered in the past.
Do you see that?
A. Yes.
Q. Okay. As of -- as of the date of this e-mail, were there -- have changes been made to the risk management of the Fund, given -- given the drawdown that had occurred?
A. Again, these were joint decisions for Catalyst, so we must have been in mid discussion. So I wrote it as though changes were made and sent it to Catalyst so that if we wanted to announce it, if they wanted to announce it, if we decided to put it on a daily risk metric, we had those discussions. We've been in discussions regarding changes as early as December.
So, again, if -- this was a -- this was a draft communication sent to Catalyst so that they could identify what did they want to publicize, what was actually in place, what we were going to do next month. So what actually happened, I don't have a clear recollection of that.
Q. Okay. Well, I mean, as of the time you

Page 249

sat down and wrote this, if there had been, you know, changes made to try to improve risk management, you would have been aware of that, right, as the portfolio manager?

A. I would have. I'm just telling you I don't recall if at this very moment, like I said, whether we had already made the changes. I wrote this expecting that there would be changes. I don't know of the timing. I don't remember which ones. I do remember that we -- you know, internally discussed a number of metrics, including delta, which is the one that finally was instituted. But, again, I also remember further discussions in March around delta, and so I don't recall exactly when that became a formal part of that risk disclosure.

Q. Of the risk disclosure, the word you just used, I'm trying to understand just your risk management. So putting aside the question -- putting aside the question of whether at this particular moment in time there had been changes made to improve risk management, whether it was on this date or in the week, two weeks, or a month after, were there -- were there -- in the wake of the February 2017 drawdown, were there changes made to how you managed the risk of the Fund?

Page 250

A. Yeah. Again, beginning of December, this was a very collaborative effort, even more so than in the past. Remember, Catalyst is the advisor of the Fund. I'm portfolio manager. And beginning December, it was a very collaborative effort, particularly in the subject of risk management. And certainly there were changes made at some point in the February, March, maybe down into April time frame. But as we sit here today, I can't tell you specific dates. I know that ultimately what survived was a delta-based risk measure. But when it was formalized, I can't tell you today when that was.

Q. And what was that delta-based risk metric?

A. It was simply monitoring the delta exposure of the Fund.

Q. So the metric was simply just a monitor? Was there a threshold or some sort of cap on -- on delta?

A. Yes, I guess that's what I mean. We start to measure and set a limit on delta exposure.

Q. Okay. And what -- was there a limit set on delta exposure?

A. I recall that there was. Like I said, I don't recall when or what it was specifically at

Page 251

that time, because it changed.

Q. And did that -- was that delta measure -- the delta metric -- that delta exposure limit, did it, in fact, improve the risk management of the Fund?

A. I don't know exactly how to answer that. One of the -- I mean, how do you measure whether the risk management of the Fund was approved?

Q. I don't think. You're the portfolio manager of a $4 billion mutual fund. So I'm just a lawyer. You tell me. How -- how do you measure that?

A. I just want to understand what question you're asking.

MR. KOPECKY: Objection. Argumentative. Don't even bother answering that.

BY MR. FOSTER:

Q. Well, the intent -- as I'm running through the document, I'm not trying to create some controversy. But the document says the intent of the changes are to improve risk management. I'm asking you -- I asked you what changes were made. You don't recall exactly when they were made, but one change to identify was the delta risk metric. And so, you know, the intent was to improve risk

Page 252

management. And I'm just asking if it worked. Did it improve the risk management in some way, shape, or form?

MR. KOPECKY: Asked and answered.

Go ahead, Ed.

A. Again, I don't know what -- what is meaningful to you in terms of proving risk management. What do you mean by is it better or not?

BY MR. FOSTER:

Q. No. No. I'm not asking a different question. I mean, the words you wrote on this page were improved risk management. So I'm just using the word that you wrote down on this piece of paper. So, you know, were there changes that post-February 2017 that were made that improved risk management of the Fund? That's just my question.

A. All I can tell you is there were changes that were made. I never received a -- any metric to understand what Catalyst was using to measure whether risk management was approved or not. So I don't know how to answer that question.

Q. You didn't have a view? You didn't have a view in the time frame of -- or at any point, did you have a -- hold a view as to whether a delta risk

metric was useful in managing risk of the Hedged Futures Fund?

A. I had a point of view that it could be useful, but it was highly dependent on where the level was set.

Q. And it sounds like where the level was set at a -- at a given threshold. Or did you agree with wherever it ended up being set?

A. We -- as I mentioned, I recall having a pretty lengthy meeting in March to talk about levels. We agreed to experiment with the particular level. We used a delta gamma combination, delta gamma 70. We -- we tried to find that level collectively for some period of time. I'm not sure we ever completely achieved a comfortable and consistent level going forward.

Q. If we go down to the next bullet, Mr. Walczak, this bullet reads: The Fund is intact. We have experienced the market conditions that are normally unfavorable for us, i.e. a rapid upside move in extremely low volatility conditions. The impact on the Fund was even more severe due to a perfect storm of conditions, some of which were our own doing. We think we have those fixed. Do you see that, those statements from the second bullet

point?

A. Yes. Yes.

Q. So the market conditions that are described, rapid upside move in an extremely low volatility conditions. Prior to February 2017, you understood that those market conditions were -- would be unfavorable to the Fund, correct?

A. Those are the type of conditions that could be unfavorable, but, again, there's no -- mandate that they're unfavorable. They tend over time to be less favorable than different conditions, yes.

Q. Okay. Had the Fund experienced those conditions in the past?

A. Most recent, I think, experience and somewhere along the way, I mentioned it, maybe in a call or something, was 2013 maybe.

Q. And what happened in May 2013?

A. In May of 2013?

Q. I'm sorry. What month did you say? I might have misheard.

A. I just said the year 2013 was a -- the more recent example that I can recall the Fund was operating above a low volatility rapid -- rapidly rising market, just that year.

Q. Okay. And what was the -- did the Fund have a positive or negative return that year?

A. Overall, I believe it had a negative return in 2013.

Q. And what about any other time that you recall? Was there a time in 2014 when there was an upside move in a low vol environment?

A. I don't recall specifics, other than I certainly know that 2013 I cited, because it was kind of a year-long scenario. But the time horizon for the Fund strategy was basically 60, 90, 120 days, so you could have a normal volatility year with a two, three, four-month low vol increase that would cause you some difficulty during that time. So there were certainly other periods, but I don't recall specifics.

Q. In the next -- so focus on the next sentence where you write, The impact on the Fund was even more severe to a perfect -- due to a perfect storm of conditions.

What conditions are you referring to there?

A. You know, again, this is a first path, and I don't remember as I wrote this. In fact, I do -- I do remember now the edit did not include some of

this language, the final version of this. But my initial assessment was we had -- we had a circumstance where very low volatility and relative to that volatility an extremely statistically rare upside move combined with what we now know to be a gamma squeeze, which was not a concept -- not familiar to anyone back in the day, but it's dealing positioning. And that exacerbated and worsened dramatically our -- the ease of exiting positions in particular prices we had to pay, and that was an example of highly extreme slippage to our exit.

Q. Okay. Bear with me. I'm going to break that down a second.

So what was statistically rare?

A. The price excursion relative to the existing level of volatility.

Q. And how did you reach that conclusion that it was statistically rare?

A. Basically, as I described earlier today, when I did my stress test, I would look at it prevailing, realize volatility in the underlying, and determine what sort of price movement I should look at in my scenario -- scenario analysis.

Again, the analogy or the examples I cited was in March of 2020, you look at a really big move.

And in February of 2017, which had, I think, the absolute historically lowest volatility of all time or very close. The difference in those conditions, you run your stats on what's the likely move? What is your standard deviation of expected price? What's the range? And by those metrics, it was a highly rare pricing.

Q. Highly rare, like, is there -- can you quantify that in any way?

A. I can, but I don't have those numbers in front of me right now. It can be done, but I don't recall.

Q. Okay. Did you -- did you run those numbers previously?

A. I have.

Q. Okay. And did you record that analysis?

A. No.

Q. So when you said you ran them -- you ran them previously, it was in your head?

A. No. I looked them up. I did a calculation, and I then stated.

Q. Okay. And then the gamma squeeze. What are you talking about there?

A. So in the -- in most options trading, and especially what we do in options of the future is to

counter party is typically dealer or market vendor. And unfortunately, understanding this fully, you've got to get into it as we started to rapidly liquidate. And, again, that was -- we can earn our 8 percent trigger. We hit the button to liquidate positions, and that liquidation forced our common parties to -- well, a couple things. Profit motive, they jacked the prices up on options table.

But their normal way of doing business is to hedge their risk, so when they sell an option, they buy a futures contract against the risks and just take it on by someone the options wants to buy, which drives the market up, which in turn increases the pricing option we're trying to buy, and you get into a negative feedback. But, again, at the time of writing this document, there was no time to have done that kind of assessment subsequent to the drawdown. That's -- that's my conclusion.

Q. Okay. The reference here to perfect storm of conditions, some of which were our own doing. Which -- which -- which conditions that comprise that perfect storm were your own doing?

A. I don't recall exactly what you're referring to, but likely, as I described it to you, just the fact of us even independent of any kind of

gamma squeeze, if you liquidate rampantly, you're likely to push prices higher.

Q. Okay. Was the concentration of the portfolio in February third week options, was that one of the conditions that was of your own doing?

A. I mean, I -- maybe, again, I don't remember from writing this, if that's something that I was -- that fell into this category.

Q. The -- if you go back up in the document, that one, two, three, fourth paragraph, which states: The recent week has been particular -- particularly volatile. February options expirations contained the Fund's largest concentration of positions both based on conditions months ago when they were entered and based on the repositioning of options from prior several expirations. So there was -- there was a concentration -- or are you saying that the concentration of the Fund in these particular February options, did that exasperate the drawdown?

A. Yeah. I mean, what I'm describing here is basically that in the normal operation of the Fund, in particular, the derisking of the Fund, because we weren't entering new positions, the largest concentration was in February. It wasn't a

particularly large concentration relative to the Fund's history. It's just that there weren't a corresponding sort of counterbalance further, because we had elected not to put on new positions until we derisked the Fund further, and we were in the process of doing that. So we ended up at this moment in time with, relative to the overall fund, a higher than normal concentration in February. But not because we went out and put on positions, but it's just we didn't put them elsewhere, because we didn't want additional positions of fund at that time.

Q. When was the decision made not to put on additional positions in the Fund?

A. I decided to do that as a part of my -- again, in my stress testing back in November of 2016. Was validated when Catalyst became heavily involved in -- in fund management, risk management in December. So the last new position, my recollection, is it was put on sometime in November. Again, in November the typical thing would be putting on February positions, so that's how we ended up with a little higher concentration than normal in February.

Q. Okay. Bear with me one second.

All right. If you could go to what's been premarked -- let me find it here -- Exhibit 34. So there's another transcript of an open house call on February 27, 2017. Do you have that document in front of you?
A. Yes.
(Exhibit 34 was marked for identification.)
BY MR. FOSTER:
Q. So this is now towards the end of the month, and how did -- how did the Fund end up for the month of February?
A. I don't know.
Q. Well, do you recall what -- where it stood in relation to the eight-day percent rolling 30-day number that you mentioned?
A. No, again, I don't have the performance numbers in front of me, so I don't know.
Q. Well, you can recall that the Fund had a big drawn down in February, though, right?
A. Yes.
Q. All right. Well, I think we've discussed that with you before. We don't need to rehash it. If you could go to page 45.
A. Okay.
Q. Okay. And so there's -- there's a participant on the call, and you're having a back-and-forth with that participant. Do you see that on page 45?

A. Yes.
Q. Okay. And the -- and so the participants are referencing a number of years in the trading, and then it goes on to say, line 12: So -- and I guess maybe I didn't -- the question didn't really -- the question didn't come out really well. And you have seen all different types of markets as they pertain to options, and how options trade, and how options decay, and, so forth?
Wasn't there at some point prior to getting closer to -- as they got -- inched closer to options expiration that you kind of said to yourself -- you knew what was going to happen as they -- as we were at -- somewhere in the month that you kind of had a sneaking suspicion of what was going to happen to the fund.
And response starting at line 23, you state: Well, no, and I can tell you, had I had that suspicion, I would have behaved very differently. All I can do is, as you said, trading options for a long period of time, as we come into an expiration period, we generally establish kind of lines in the sand.

All our analytical suites suggested that the market was already significantly overextended. We drew a line in the sand and said that all of this is false if we break through this line. We broke through that -- through the line. We took positions off. The sensitivity of the options and the dramatic nature of the move led to a larger drawdown than it had in the past.
Do you see that?
A. Yes.
Q. When you referenced analytical suites, what are you referring to?
A. Things we've looked at in terms of -- again, I've talked about standard deviation moves. So we look at where the market has been, where it might go, what's the current level of volatility. We looked at deviations from moving averages, you know, the mean version stuff we talked about today. So as far as I can recall, that's the sort of thing that I was referencing.
Q. So, again, you go on and starting at line 11 on the same page, 46: So, again, for me it was a perfect storm. We've had drawdowns under similar conditions in the past. This one was significantly worse. It looks like the drawdown that I had in the fund back in '07, which was for different reasons.

And, unfortunately, you go through -- you go through these drawdowns and you say, what failed in the way that we were managing risks and running the fund, and then you try to come out the other side having corrected those failures. And that's essentially what we're doing now.
Assuming -- let me stop there for a second. What -- what were the failures that you identified, if any? What failed in the way that you were managing risks and running the Fund and that you tried to correct?
A. At that time I don't actually, you know, I don't recall what I was referring to in this particular call. It's too long ago.
Q. Well, do you recall what -- what failed, if anything, in the way that you were managing risks at that time?
A. So, again, my comment is simply to -- to answer the question and to talk about what we typically do in a drawdown situation, that is go through an analysis, identify where there might be failures, what can we do better on the other side.

So I don't know if we had identified, at this juncture, specifics, you know, maybe, maybe not. But this is really a description of a process that says, Okay. Why don't we get a bigger drawdown than we'd like.

Why can't we do a -- I don't know if there were any hard-and-fast conclusions at that point that drove my comments.

Q. Going over to page 48, on or about the line 13, you say: So, clearly, we didn't have something in place; the risks went too far.

What didn't you have in place at the time that would have helped you manage the risk that presented themselves?

A. Again, I think this comment actually illustrates what I was talking about. The something is TBD, we're saying clearly the result isn't what we wanted, so there must have been something that must be built, but we're not sure what it is yet. But we're --

Q. Okay. Did -- did you -- did you determine what it was? You went through this in the past what -- what did -- what in place -- should have been in place at the time?

A. We did ultimately --

MR. KOPECKY: Objection. Note my objection there. And objection to the form and foundation what would have been in place.

But go ahead, Ed.

A. Yeah. We identified later that it's -- if we -- you know, if we put in a delta metric, we might have avoided some of the drawdown. At the same time, part of our conclusion was that this was a -- you know, a once in -- you know, this was a once in really 20 year type of event. So you want to be careful about managing a strategy to a one-in-20-year event. So the question became if you put in a delta, does the strategy actually make any money anymore? But that's the one feature that we did put in place, as I said, at some point down the road.

Q. Well, if you -- if you scroll down on this same page, right, page 48, line 24, you say: But we've put metrics in place that would have prevented this particular occurrence.

A. Yes.

Q. So as of the date -- the date of this house call, what metrics were put in place, then? You're saying it would have prevented this particular drawdown.

A. I -- I honestly don't remember which ones that's referred to.

Q. All right. Well, putting aside what you remember, what you're referring to in this document, were there metrics that were subsequently put in place that would have, quote/unquote, prevented this particular occurrence?

A. We did put a delta metric in, but, again, we, at least in my tenure with the Fund, never went through any environment that's even close to that February period. So the answer is still uncertain. But we did add a delta metric in hopes that it would have prevented this.

Q. Okay. So you don't know what you're referring to here in this -- this house call transcript when you talk about metrics that have been put in place?

A. Yeah. I don't remember which ones I've been referring to.

Q. Okay. Let me -- let me cover one more document with you, Mr. Walczak, and then I'll let you go. Give me one more moment to pull it up, please.

Well, before we do that, we were talking about a delta risk metric being put in place. But,

again, OptionVue incorporated delta -- the delta -- delta risk information, correct?

A. OptionVue allowed me to see individual options, summary, option Greeks, delta, theta, beta primarily.

Q. Okay. And in the -- in the month of February, leading up to, you know, from the beginning -- pretty much all throughout the month of February, you were -- were you receiving reports from Catalyst in New York that contained delta information?

A. Yeah. We had decided in January to begin to test delta and see whether it was relevant to the behavior of the portfolio. So the early returns in February were not encouraging. It looked -- the math got the direction problems. And I later did a study that suggests for this kind of option trading, delta was not particularly informative. I think we had some analysis that's at 25 percent of the time, I got the direction wrong. Predicted the Fund would lose money, when it actually made money. So the jury was certainly out. But -- but it was something that I thought had some promise. But, you know, it's nondirectional fund. So using a directional metric didn't seem intuitive to me, but we had

Page 269

agreed to start monitoring it to see whether or not it had some predictive value. Started, I think, the first of February to look at it.

Q. Well, did you -- you expressed that it didn't have utility or you didn't think it had utility. That was your view.

Did others at Catalyst share that view?

A. Well, my view was I didn't -- I never used it in -- in, you know, 12 years of operating the Fund. So I didn't know, which is why I said let's take a look and see what it looks like after we got some history.

Q. Why do you say you didn't use it? I mean, again, we just covered that wasn't among other great metric, OptionVue, the modeling software tool that you used incorporated delta information, right?

A. Yeah, it did. I mean, the reason I didn't use it was the type of options spreads I used. For example, the call ratio spread will show you a short delta and will make money if the market goes higher. So, you know, that -- that's just the way I use options. I'm not using them to make directional bests. I'm using directional indicator. Again, it didn't seem intuitive. In particular, one of the spreads I used most commonly, as I mentioned, you

Page 270

put it on, delta says negative. And yet you make money if the market goes higher in most cases.

So, again -- again, obviously, delta's a very common metric. So I was certainly interested to see whether it might have some utility. But I've never used it, and I have nondirectional funds. So that's not how I use the options listed. Take direction at best.

Q. Why don't you turn to what's been marked as Exhibit 21.

A. Got it.

(Exhibit 21 was marked for identification.)

BY MR. FOSTER:

Q. Okay. And this document has a Bates number of Catalyst_005_0118107. It also bears a prior exhibit number of Division Exhibit SEC 46.

Do you recognize this document?

A. Yes, I've seen this before.

Q. Okay. This is an e-mail from Ms. Rios to you on December 10th, 2016. And the subject matter is, Booking losses phone call.

A. Yes.

Q. Okay. And in this -- and this e-mail's coming on the heels of the Fund suffering a drawdown in December 2016, right?

Page 271

A. I believe so, yes.

Q. And among other things, Ms. Rios writes that from what she sees, a 1 percent upmarket move is equivalent to a 5 percent decline and NAV.

Do you see that?

A. I see that.

Q. Okay. Were you aware of that information in December 2016?

A. Yeah, I appreciated her doing that analysis. A good thing to surface before we had our phone call to determine the item received.

Q. And were there -- were there -- so this is -- she's writing this at -- on December 10, 2016, but did that -- did that correlation, a 1 percent upmarket move equivalent to at least a 5 percent decline, was that -- was that true on other days in either December or February of 2017?

A. I'm not certain it was true at the time she wrote the e-mail. I don't know what settings or assumptions she was making about the portfolio and volatility and all the different things. But, like I said, you know, Kimberly's a smart woman. And I appreciate her surfacing. This is good information, because we were about to get a phone call and discuss this recommendation, others from Catalyst

Page 272

recommendation, my own files, and we did that. We -- and I don't remember the specifics. I don't remember if we executed any of this -- of her suggestion or did something different. But we had a good discussion. We agreed on what actually to take, and thus my memories -- like I said, we agreed on a solution. We came out, and the solution turned out to be, you know, pretty effective for December.

Q. And why do you say that?

A. Well, because we're in a drawdown that I don't remember how deep it went, but we recovered. We mitigated the further drawdown and -- and recovered by months' end to -- if that 4 percent number's accurate, from a previous exhibit, to account for 4 percent of December, and then proceed to have a positive January. So this -- this whole discussion was going on in the December drawdown.

Like I said, she really did a nice job of surfacing, you know, one solution. And pointing out what she saw as a risk. We had a discussion. I think that's how things should work. And it was effective.

Q. Okay. We could look at the trade log and determine whether -- whether her suggestion was implemented or not, right?

Page 273

A. We probably could, sure.

Q. Okay. Did you recall whether you agreed with her suggestion of how to reduce risks in February?

A. I don't remember, because, again, I didn't know from her e-mail exactly what assumptions she was making, what kind of time frame she's looking at, 1 percent move tomorrow, a week, month, whatever. So I have a lot of questions. But, as I said, I know she's -- she's a smart woman, and she's perfected at surfacing the risk. And, again, I don't remember the specific discussion about the phone call. But I do remember she participated. The whole Catalyst team participated. We tossed around solutions like this. We tossed around my ideas, Catalyst ideas, and we came up with a way that we felt was a good balance to manage the risk most effectively, which is what -- you know, what we always did.

Q. What do you mean that's what you always did?

A. Well -- well, once we started to have these collaborative meetings around risks, which began right about this time in early December, we had many, many, many ongoing discussions. Catalyst

Page 274

risk even myself and Kimberly, of course, to -- to talk through if there were some stress on the Fund, if there was a volatile day in the Fund, to talk through what we should do about it. And I think that was -- that was pretty effective in, you know, having more collaborative collective decision. We did the same thing in February. We don't know if it was better or worse there was, but it was all hands on deck. So that that's what we --

Q. The only one in the place in trades in the Fund was you; is that right.

A. Yes, that's correct.

Q. And you had the ultimate say over -- over what trades to make or not make in the Fund, right?

MR. KOPECKY: Objection. Form and foundation.

A. No. Actually, the advisor did. And there were certainly times when I disagreed, but I followed instructions.

BY MR. FOSTER:

Q. But you were the -- you and Ms. Rios were the only -- you were disclosed as the portfolio manager, correct?

A. Correct.

Q. In this time period, and Ms. Rios was the

Page 275

coportfolio manager?

A. I think during this period. I don't remember when we -- she became concerned about the regulatory interest in the Fund. I think after her testimony, she became a bit upset and asked me if she could leave the Fund. So -- but at this time, I think she was the coportfolio manager.

Q. So you indicated that you had some questions in your mind about, you know, how she was arriving at this -- this statement here, 1 percent upmarket move is equivalent to 5 percent decline in NAV. Do you know what assumption she was making and what that was based off? Did you ask her those questions?

A. I don't remember. I think it might have been a phone call. We might have just proceeded. It was a Saturday. I don't remember when I actually saw this e-mail. I don't remember when the phone call was, so it may be that I didn't have a chance to talk to her until we got the group together. I just don't remember.

Q. Before mid-February 2017, was there ever a time or times that you disagreed with what someone else at Catalyst was -- was instructing you to do with respect to managing the Fund, but you did it

Page 276

anyway?

A. Right up until the last part, I think I understood your question, but I don't -- I'm not sure I understand the whole question.

Q. Well, one of you prior responses, you indicated there were times that you disagreed, but you followed instructions and went ahead and made -- took certain steps in trading for the Fund. Did that ever occur before the mid-February 2017 time period?

A. I don't recall specifics other than that certainly occurred. December of -- I don't know when -- but that wasn't an unusual occurrence. We had constructive discussions. We sometimes had heated discussions. We tossed back and forth alternatives. And, as I said, I was always very conscious of the fact that I served at the advisors' pleasure, so to speak. And if they, you know, if we disagreed and they wanted something done, I did it.

Q. What Ms. Rios is stating here is that the Fund from her -- from what she saw from her perspective, what was highly sensitive to an upmarket move, right?

A. Well --

MR. KOPECKY: You can't say what Kimberly

was thinking.
Go ahead and answer as best you can.
A. It looks like that's what she's describing. But, once again, my first question, you know, if I'm seeing this today for the first time, I'm wondering whether -- what time frame she's using. That's just not clear to me, so there are a lot of questions when you come up with something like this. And, again, Kimberly was, you know, very skilled. And I valued her opinion, but at the same time, I'm not sure what she's -- you know, I would need some more information. But it's useful that she raised them.
BY MR. FOSTER:
Q. Okay. Well, the useful information she raised, if it was, in fact, true, this would be -- would that have been of concern to you?
A. Yes, absolutely.
Q. And that would have told you that there was a lot of risk in the Fund, if it was true, right?
A. Well, again, true, it means what scenario is she looking at? So -- so it could certainly be true if she was looking at a 1 percent move in the next ten minutes. That might not be relevant. So

if she didn't make a mistake in a modeling selection and option, if -- if -- if, certainly there would be concern.
Q. Okay. But you -- you believe that whatever questions you had at the time concerning the dates as per Ms. Rios' statement that you -- you know, this was a pretty significant thing she was saying. So do you think you satisfied yourself and got answers to all these questions that you're raising now?
A. I'm certain that we had a healthy discussion that the phone call that she refers to. And I'm certain coming out of that discussion that we had a consensus of what actually is to take and that I executed those actions.
Q. Can you give me one concrete example that you remember of you entering a trade for the Hedged Futures Fund that you were ordered to make but that you disagreed with?
A. I can't cite an example for you other than during this period of time, I remember having some disagreement in December with the actions that Catalyst wanted me to take, but agreeing to take them.
Q. Can you -- can you give me an example? Do

you remember ever refusing to enter a trade that you were ordered to make?
A. No.
Q. That never happened?
A. I don't remember one time.
Q. Okay. In this -- in this time period in December 2016 through February 2017, did you want to be more aggressive or more conservative -- conservative than what Catalyst wanted?
A. I -- I don't remember characterizing as more aggressive or more conservative. It's more a matter of technique, what actions to take. I think we all agreed that we need to be more conservative. That was the point of disagreement when there was some. And I don't mean to categorize there was always disagreement. But there was certainly always active discussion between myself and Catalyst during this time.
Q. Mr. Walczak, let me show you one last document. Can you pull up Exhibit 36?
A. Okay. Got it.
(Exhibit 36 was marked for identification.)
BY MR. FOSTER:
Q. All right. And Exhibit 36 is your answer to the SEC's complaint in this case.

Have you seen this document before?
A. I probably have. I've seen a number of legal documents. I can't swear that I've seen this one, but probably.
Q. Do you have any recollection of reviewing -- you understand there was a response filed on your behalf to the complaint in this case?
A. Yeah, I do. If that's what this is, like I said, I don't really recognize legal documents sometimes, but I do recall that a response was filed. And I do recall reviewing that with counsel.
Q. Okay. And did you review it to ensure that your answers were accurate?
A. I -- I reviewed it with counsel to ensure that -- yeah, that my answers were accurate.
Q. Okay. Once we've talked about previously that -- that the complaint allegation included references, citations, quotations to certain house calls. So if you turn to paragraph 51. Okay. 51 is quoting statements from the open house call on November 4, 2014.
Do you see that?
A. Yes.
Q. Okay. And we reviewed a transcript from for that house call earlier today.

Page 281

Do you recall that?
A. Yes.
Q. Why did you deny paragraph 51 to the complaint?
A. I'm not sure what paragraph 51 is alleging.
Q. Well, you can read it. You can see what it alleges, right?
A. Well, unless I'm missing something, paragraph 51 says, for example. So I don't know what -- what I'm denying here.
Q. Okay. So you're not able to tell me why you denied paragraph 51?
A. I don't recall. Again, conversation with counsel. I'm not familiar with incorrect way to respond to these things -- respond to some of these things. But, again, I don't -- I don't see something I'm denying specifically on paragraph 51.
Q. Okay. Did you deny -- do you know if you denied the paragraph, because the house call was not accurately quoted? Are you taking issue with -- with the fact that you made these statements on the house call?
MR. KOPECKY: I'm going -- I'm going to object. Mike, we've been through this. He answered

Page 282

in the interrogatories. He answered these in consultation with counsel. He's not going to tell you what his counsel told him, because I'm not going to let him. And he just said, I don't really recall what it was after my conversation with counsel. We're past seven hours, according to my calculation.
The two documents before you said was your last you were gonna show him. So -- I'm objecting to continuing this line of questioning. What do you -- what do you have left?
BY MR. FOSTER:
Q. Okay. So if I asked you the same question about any of the other allegations concerning the house calls, all of which you denied, are you able to tell me why you denied the paragraphs concerning the house calls in the complaint?
MR. KOPECKY: Objection. Form and foundation. You have to look at each of them individually, which you don't have time to do, because your seven hours are up.
MR. FOSTER: You are instructing the witness not to answer.
MR. KOPECKY: Mike, I want to give you some leeway here. I'm not -- I'm instructing him not to answer that question, because he'd have to

Page 283

look at each individual paragraph to then go through whether he remembers specifically why that paragraph was denied or not denied, or if he was involved with counsel in that paragraph or not in that paragraph. And we don't have time to do that. But I don't want to cut you off, if you have another topic or question that you -- that you really would like to get in.
MR. FOSTER: Well, I want to get into this topic, because we served interrogatories that asked for the basis for denials. Those interrogatories did not provide any sufficient explanation as to why these paragraphs were denied.
MR. KOPECKY: I disagree. So why don't you pull up the interrogatories and pull up the letter we sent where we described the basis for those denials and show him those and see if it refreshes his recollection as to why paragraphs were denied. It's seven hours going --
MR. FOSTER: I'm sure -- I'll show his interrogatories, if you want me to.
MR. KOPECKY: No. And show him the letter, which I've already responded to explaining why certain paragraphs were denied. It's not a productive use of time. If the court reporter can

Page 284

confirm where we're at on the time on the record, please.
THE REPORTER: I will need a moment to do so. I don't have a rough calculation.
MR. KOPECKY: I've got us now beyond seven hours. Does anyone disagree with that?
So I don't have to instruct him not to answer. If you weren't keeping that -- the time, I can't help you. It's beyond seven hours, so, yes, I instruct him -- the deposition's now beyond the limit allowed by the rules.
MR. FOSTER: Okay. So you're -- you're instructing him not to answer my questions about the basis for his denials --
MR. KOPECKY: No. I'm -- I'm instructing him not to answer. I'm ending the deposition, because we've gone beyond the seven-hour limit.
MR. FOSTER: Okay.
MR. KOPECKY: I don't even have to instruct him.
MR. FOSTER: The primary -- the primary reason that we've gone beyond the seven hours is your speaking objections and your client's nonresponsive answers to -- to questions throughout the day.

So you guys burned the clock, not me, but that's okay. We don't have to figure that out right now. But one way or the other -- one way or the other, we'll get an answer as to why you denied these allegations. It seems to be something you're just refusing to inform us of.

MR. KOPECKY: I wrote you a letter. Respond to my letter. I wrote -- the day I wrote you the letter. I wrote a letter explaining why they were denied, and we responded to interrogatories.

MR. FOSTER: Yeah. And your -- and your letter --

MR. KOPECKY: And --

MR. FOSTER: And your letter didn't say anything, and it was much easier just to deal with it in his deposition. Then, of course, his deposition got postponed, which is fine. Happy to -- no fault of anybody on the call. But now here we are. I'm asking the questions, trying to get the information -- I can take up the Court's time. I can file a motion to compel. And it's going to cost a lot of resources. Or I can ask him in -- in the deposition.

MR. KOPECKY: Mike, we can confer on that,

then, because I already responded by letter detailing why they were denied. If you don't like those responses, then I don't know what to tell you.

But you didn't accurately quote -- you took things out of context. You used the word said. All of those are legitimate reasons why we denied paragraphs and the answers to interrogatories. So let's not go back and forth on it. You can either follow-up on my letter, or you can confer, you can bring a motion.

But the dep -- I mean, again, if you had, like, a different topic or something you wanted to cover really quick, we'll stick around beyond the seven hours. But if it's going to be about the answer to the complaint or interrogatories, then I'm not sticking around. We're ending the dep.

MR. FOSTER: Okay. Those -- those are my remaining questions, so we'll -- we'll deal with those outside of the deposition.

MR. KOPECKY: Okay. Then we're going to -- we'll take a five-minute break so I can consult with my client and my co-counsel to see if we have any questions we want to ask now.

MR. FOSTER: Okay.

VIDEOGRAPHER: We're going off the record

at 6:12 p.m.

(Recess taken.)

MR. KOPECKY: So we do not have any questions at this time, and we'll reserve signature.

THE REPORTER: Would you like a copy of the deposition, Mr. Kopecky?

MR. KOPECKY: Pardon me?

THE REPORTER: Would you like a copy of the deposition?

MR. KOPECKY: If they order it written, yes. Okay. We all good?

MR. FOSTER: Thank you, everyone.

(Deposition concluded at 7:18 p.m. EST)

- - - - -

CERTIFICATE OF WITNESS

I, EDWARD WALCZAK, do hereby declare under penalty of perjury that I have read the entire foregoing transcript of my deposition testimony, or the same has been read to me, and certify that it is a true, correct and complete transcript of my testimony given on July 27, 2021, save and except for changes and/or corrections, if any, as indicated by me on the attached Errata Sheet, with the understanding that I offer these changes and/or corrections as if still under oath.

_____ I have made corrections to my deposition.

_____ I have NOT made any changes to my deposition.

Signed: ___________________________

EDWARD WALCZAK

Dated this ________ day of ______________ of 20____.

REPORTER'S DEPOSITION CERTIFICATE

STATE OF FLORIDA
COUNTY OF VOLUSIA

I, Vanese Killingbeck, Professional Reporter and Notary Public, certify that I was authorized to and did stenographically report the deposition of EDWARD WALCZAK, pages 6 through 281; that a review of the transcript was requested; and that the transcript is a true record of my stenographic notes.

I further certify that the deposition was taken remotely within the State of Florida at the time and place specified herein above and that I am not a relative, employee, attorney, or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

Dated August 10, 2021.

____
Vanese Killingbeck
Registered Professional Reporter

ERRATA SHEET

Deposition of: EDWARD WALCZAK
Date taken: JULY 27, 2021
Case: SEC v. EDWARD WALCZAK
PAGE LINE

_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________
_____ _____ CHANGE: ______________________________
REASON: ______________________________

Signed______________________________
Dated______________________________